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Supreme Court, U.S.
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NO. 88

In The

Supreme Court of the United States

September Term, 1988

CAUCUS DISTRIBUTORS, INC., and CAMPAIGNER PUBLICATIONS, INC., New York Corporations, INDEPENDENT DEMOCRATS FOR LAROUCHE, an unincorporated association, RON FREDMAN, RONALD R. BETTAG, PAUL GREENBERG, and all other parties and organizations acting in concert with the named Petitioners,
Petitioners,

v.

MINNESOTA COMMISSIONER OF COMMERCE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE MINNESOTA COURT OF APPEALS

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QUESTIONS PRESENTED

1. May notes evidencing a loan transaction made to a first amendment political group by a supporter constitute securities under the Minnesota Securities Act?

2. Has the regulation of federal election campaign organizations been preempted by federal law to the extent that the Minnesota Securities Act does not apply to such an organization when a supporter makes a loan in conformity with FEC rules and regulations and receives a promissory note in return?

3. Do the first amendment rights of politically oriented organizations and the individuals who support them prevent a State from using securities law to inhibit the fund raising activities of those organizations?

4. Was the sanction imposed by the Administrative Law Judge precluding Petitioners from contesting the cease and desist order improper in view of Petitioner's first amendment rights?

PARTIES BELOW

The parties in the Minnesota Court of Appeals were Petitioners, Caucus Distributors, Inc., Campaigner Publications, Inc., Independent Democrats for LaRouche, Ron Fredman, Ronald R. Bettag, and Paul Greenberg and all other parties or organizations acting in concert with the above named Petitioners, and Appellee, Minnesota Commissioner of Commerce.

Caucus Distributors, Inc. and Campaign Publications, Inc. are not owned by any parent companies, have no affiliates or non-wholly owned subsidiaries.

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Petitioners,

v.

MINNESOTA COMMISSIONER OF COMMERCE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE MINNESOTA COURT OF APPEALS

Petitioners, Caucus Distributors, Inc., Campaigner Publications, Inc., Independent Democrats for LaRouche, Ron Fredman, Ronald R. Bettag, and Paul Greenberg pray that a Writ of Certiorari issue to review the judgment of the Minnesota Court of Appeals

OPINIONS BELOW

The order of the Minnesota Supreme Court denying Petitioners petition for further review is attached as Appendix A. The opinion and order of the State of Minnesota Court of Appeals is printed as Appendix B. The opinion and order of

the Minnesota Commissioner of Commerce is printed as Appendix C. The Findings of Fact and Conclusions of the Administrative Law Judge are printed as Appendix F-1.

JURISDICTION

The judgment of the Commissioner of Commerce, State of Minnesota was entered September 3, 1987. The judgment of the Court of Appeals of the State of Minnesota was entered March 30, 1988. A timely petition for review of the decision of the Court of Appeals was filed in the State of Minnesota Supreme Court. That petition was denied on June 10, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

STATUTES INVOLVED

Minnesota Securities Act of 1959, Section 80A.14 (Appendix D). Also, Federal Election Campaign Act, 2 U.S.C. 431

STATEMENT OF THE CASE

In December, 1985, the Minnesota Department of Commerce issued an Order for Report of Sales to Caucus Distributors, Inc. (Caucus), a New York non-profit corporation, and/or Campaigner Publications, Inc., also a New York corporation and to Independent Democrats for LaRouche, an unincorporated association and federal political committee recognized by the Federal Election Commission. On February 10, 1986, counsel for Petitioners replied noting they would provide limited information due to the First Amendment nature of the organizations. A second letter was sent by counsel to the Department dated March 6, 1986, which reiterated the First Amendment nature of the organization, provided copies of an acknowledgment of debt and a non-

negotiable document captioned "Unsecured Promissory Note." On behalf of the corporate Petitioners, counsel asserted the First Amendment as a bar to further disclosure concerning the memberships and supporters of the organizations. The correspondence also noted that, based upon the context of the transactions, i.e. loans to political/socio-economic organizations, the loan or loans in question were not securities. Counsel again reiterated this position by letter dated May 22, 1986.

The Department, evidently electing not to pursue resolution of this issue by a Minnesota court, declined to employ the provisions of the Minnesota laws which permits a court to enforce the Order for Report of Sales and Subpoenas by the Department. Minn. Stat. Sec. 80A.20, Subd. 3 (repealed Laws 1987, Ch. 336, effective July 1, 1987).

On June 4, 1986 a Cease and Desist Order was issued by the State of Minnesota, Commissioner of Commerce, along with a Notice of Right of Hearing. On July 17, 1986 an Amended Cease and Desist Order was issued alleging that Petitioners had sold unregistered securities through unlicensed agents in the State of Minnesota.

An initial hearing was held on August 4 and 5, 1986. Because of the 11th hour (July 31) subpoenas by the Department, the hearing was continued after testimony by one witness, Mary Mitchell, who had subscribed to the various publications disseminated by Petitioners, supported many of their political and economic viewpoints and who had also made loans to Petitioners.

The hearing was continued so that the Administrative Law Judge could read various briefs that were to be re-submitted on discovery issues and Petitioners objections to discovery. On October 6, 1986 the Administrative Law Judge reversed an

earlier ruling and issued an Order for Discovery which required organizational Petitioners to provide additional information to the State of Minnesota concerning the identities of persons who had made loans to Petitioner organizations. The Administrative Law Judge did find that Petitioners had shown that their supporters reason to fear disclosure of their identity and the claims of a chilling effect were reasonable and realistic. Petitioners had also pointed out, without success, that the State had never interviewed all of the persons whose names they had been given by Petitioners earlier in the case pursuant to an earlier order. On October 24, 1986 the State moved for an order precluding Petitioners from contesting certain allegations in the amended cease and desist order because it was the State's position that Petitioners had not complied with the Administrative Law Judge's discovery order. On December 2, 1986 the Judge denied the Enforcement Division's request for preclusion. On December 15, 1986 the judge issued another Discovery Order. The Judge directed the organizational Petitioners to provide various information concerning Minnesota residents who had lent money to Petitioners. Since Petitioners had submitted John Doe affidavits from a number of Minnesota citizens requesting anonymity, the Judge asked for a list of all those who had not requested anonymity and of the persons who had requested anonymity, the Judge requested information so that he could randomly select 25% of those who had asked their names not be disclosed (a number of Petitioner's supporters had submitted affidavits alleging fear of retaliation and reprisal if their support for Petitioners became public knowledge) and provide it to the Minnesota Department of Commerce and the Attorney General's office. On December 23, 1986 the Petitioners respectfully declined to disclose any additional names of Minnesota residents who had lent money to Petitioners on First Amendment grounds. Previously, on November 12, 1986 counsel for Petitioners had sent a letter to the Administrative Law Judge advising him that the total number of loans in Minnesota consisted of loans obtained

from 48 people. The Administrative Law Judge was advised that there was some 54 loans altogether, 24 for Campaigner Publications and 30 for Caucus Distributors. On January 13, 1987 the Judge issued an order denying Petitioners request for an interlocutory appeal of his discovery order. On January 27, 1987 the Administrative Law Judge issued an Order Imposing Sanctions for Noncompliance with Discovery on all Petitioners including the individuals. That Order precluded Petitioners from introducing evidence contesting the last sentence of paragraph 1 and paragraphs 2 and 7 of the Department's Amended Cease and Desist Order. The paragraphs in question dealt with the fact that promissory notes were offered or sold to persons in the State of Minnesota and that those promissory notes constituted securities within the meanings of Minnesota State 80(a).14 and, further, that material facts were omitted in the course of obtaining the loans upon which promissory notes were based. The sanction order, for all practical purposes, constituted imposition of a default judgment against Petitioners.

On April 20, 1987, the United States of America filed a petition against Caucus Distributors, Inc. and Campaigner Publications, Inc. seeking to place them in involuntary bankruptcy in the United States District Court for Virginia. Presently, Caucus Distributors, Inc. and Campaigner Publications, Inc. are under the control of interim trustees. A hearing on the bankruptcy issues was scheduled for May, 1988, but as yet no decision rendered.

On July 15, 1987 the Administrative Law Judge issued his Findings of Fact, Conclusions and Recommendations. (Appendix F) On September 3, 1987 the Commissioner of Commerce issued his Findings of Fact and Conclusions of Law and Order (Appendix C), stating that Petitioners shall cease and desist from offering or selling any security or promissory notes or other debt instruments in the State of Minnesota without filing said instrument pursuant to Chapter

80(a) or without obtaining an opinion letter from the Department of Commerce that exempted such instruments. The Department has taken the view that any loan to Petitioners by a Minnesota resident is a security whether or not a note is issued.

On September 9, 1987 Petitioners filed a Petition for Writ of Certiorari in the Court of Appeals. On October 6, 1987 the Writ was granted. On March 30, 1988 the Court of Appeals, State of Minnesota, Judge Randall, issued its decision. The Minnesota Court of Appeals affirmed the Commissioner of Commerce's holdings stating that the promissory notes Petitioners issued constituted securities under Minnesota Statute Section 80A.14; the Federal Election Campaign Act did not preempt regulation of the issuance of securities by Petitioner, Independent Democrats for LaRouche, a federal election campaign committee; Minnesota securities laws as applied to Petitioner's fund raising activities did not impermissibly infringe on Petitioner's first amendment rights of association and the discovery sanctions by the Administrative Law Judge were not an impermissible infringement upon Petitioner's first amendment rights. Petitioners filed a timely petition for further review to the State of Minnesota Supreme Court. This petition was denied on June 10, 1988.

REASONS FOR GRANTING WRIT

I. THE MINNESOTA COURT HAS APPLIED THE MINNESOTA SECURITIES LAW INCORRECTLY AND IN CONFLICT WITH THE FEDERAL CONSTITUTION AND WITH DECISIONS OF THIS COURT.

This case concerns a Cease & Desist Order issued by the State of Minnesota, Department of Commerce, Commissioner of Securities, alleging that Caucus Distributors, Inc., Campaigner Publications, Inc., Independent Democrats for LaRouche, and the individual defendants were selling unregistered securities.

The alleged securities were non-negotiable promissory notes issued by the above organizations acknowledging loans made by political supporters. Caucus Distributors, Inc. is a non-profit New York corporation, Campaigner Publications, Inc. is a New York corporation that effectively operates as a non-profit entity, Independent Democrats for LaRouche is an unincorporated association and political committee recognized by the Federal Election Commission. The individual defendants were volunteers and consultants for the above entities.

These organizations support and disseminate materials that discuss political, social and economic issues of interest to the general public. The State of Minnesota, by its actions in this case, has treated these organizations as business entities ignoring the obvious first amendment goals and aims involved in their activities. This is a case of first impression in Minnesota. The essence of the Minnesota Court's decision is that promissory notes are securities regardless of the first amendment impact of such a decision and the fact that the

Minnesota Statute specifically commands that the context and circumstances of each case be examined in defining a security. This Court has never ruled that promissory notes are always securities within a "plain meaning" approach. See Landreth Timber Company v. Ivan K. Landreth, 471 U.S. 681, 105 S.Ct 2297, 85 L.Ed2d 696 (1985) where this court stated:

> "'Note' may now be viewed as a relatively broad term that encompasses instruments with widely varying characteristics depending on whether issued in a consumer context as commercial paper or in some other investment context. See id., at __. We here expressly leave until another day the question whether 'notes' or 'bonds' or some other category and instrument listed in the definition might be shown by proving 'only' the document itself. (SEC v. C.M. Joiner Leasing Corporation, supra, at 355.) We hold only that 'stock' may be viewed as being in a category by itself for purposes of interpreting the scope of the Act's definition of securities."

The Minnesota Act is substantially similar to the Federal Acts in its definitions. In Section 80A.14 definitions, the Minnesota Act states:

> "When used in Section 80A.01 to 80A.31, the terms defined in this section have the meanings given them unless the context otherwise requires." The Minnesota Act then goes on in Subdivision 18 and defines security as:
>
> "Security (a) "Security" means any note; stock; treasury stock; bond..."

The first amendment impact of the Minnesota Court's decision is great and in effect holds that the State's rights to define what is a security and then to impose a regulation outweighs a substantial, direct and debilitating impact on petitioner's first amendment rights.

The weight of precedent makes it clear that in determining if a promissory note is a security the circumstances and substance of the transaction must be examined. See United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 95 S.Ct 2051, 41 L.Ed2d 621 (1975); SEC v. W.J. Howey Company, 328 U.S. 293, 66 S.Ct 1100, 90 L.Ed 1244 (1946); Marine Bank v. Weaver, 455 U.S. 551, 102 S.Ct 1221, 71 L.Ed2d 409 (1982); and Landreth Timber Company v. Ivan K. Landreth, 471 U.S. 681, 105 S.Ct 2297, 85 L.Ed2d 692 (1985). See also Ansorge v. Kellog, MI Ct. of App. (1988) (Appendix H); No. 86910 and Froelich v. Caucus Distributors, Inc., Ill Cty Cir. Ct., No. 86L17562 (1988). (Appendix G).

In this case the petitioners argue that the first amendment aspects of the Petitioner organizations are among those circumstances and must be weighed with great deference in the initial determination of whether or not a security is involved in the transaction in question. The ruling by the Minnesota Court of Appeals is wrong because it classified the promissory notes in this case as securities without regard to the first amendment purpose of the Petitioners and the first amendment nature of the fund raising activity being conducted.

The State of Minnesota has tried to treat these loan transactions as if they were investments as that term is used in the context of a security. An examination of the context of the loans makes the first amendment concerns very clear. The appellant organizations do not make or distribute profits, workers are paid minimum amounts or are volunteers. The money received by the organizations are spent disseminating books, pamphlets, newspapers and other materials that discuss issues seen as important to society and the voters.

In examining the context of these transactions the State must regulate carefully with appropriate deference to the first amendment. See In re Primus, 436 U.S. 412 (1978).

> "Where political expression or association is at issue, this court has not tolerated the degree of imprecision that often characterizes govern ment regulation of the conduct of commercial affairs. The approach we adopt today in Ohralik posts, p.447, 56 L.Ed2d 444, 98 S.Ct 1912, that the state may proscribe in person solicitation for pecuniary gain under circumstances likely to result in adverse consequences cannot be applied to appellant's activity on behalf of the ACLU." at 437.

The Minnesota Court of Appeals stated in its opinion that Petitioners were not engaging in first amendment activity in seeking loans. Fund raising is vital to a political party or organization, particularly a small one. In the case of Federal Election Campaign Committee v. Hall-Tyner Election Campaign Committee, 678 F.2d 416 (1982, 2 Nd Cir.), Judge Kaufman stated:

> "Acknowledging the importance of fostering the existence of minority political parties, we must also recognize that such groups rarely have a firm financial foundation. If apprehension is bred in the mind of contributors to fringe organization by fear that their support of an unpopular ideology will be revealed, they may cease to provide financial assistance. The resulting decrease in contribution may threat the minority parties very existence. Society suffers from such a consequence because the free flow of ideas, the life blood of the bodily politic, is necessarilly reduced. Accordingly, a nation dedicated to free thought, free expression cannot ignore the grave results of facially innocuous election requirements."

This is exactly the situation in the instant case. Petitioners assert that it is not enough in this case to decide, as the lower

court did, that the notes are securities and then hold that the State has a compelling interest in regulating securities. Therefore, Petitioners first amendment interest are overcome. It is the position of Petitioners that the first amendment interest must be considered in determining if there is, in fact, a security involved in the transaction. This is "the context" in which the transaction took place. Petitioners concede that the State has an interest in regulating the sale of securities. Petitioners point is that in the context of this case, these notes are being used to raise funds in connection with a political first amendment purpose and, therefore, should not be considered securities in the first place.

Further, it is apparent that if notes issued in the context of this case are considered securities no political organization could ever comply with the required reporting and disclosure requirements of a State's Securities Act. Almost all the State's Securities Acts are based on the Uniform Securities Act and require that the organizations issuing securities fit criteria which are completely unrealistic when applied to a political organization. Political organizations usually do not have large capital assets and they do not tend to accumulate capital. Political organizations do continuous fund raising and most State's registration requirements would demand that they set specific times to begin and end fund raising. Political and first amendment associational organizations differ even from religious organizations in that they do not, as a rule, accumulate large items of property or large asset bases.

These organizations would not be able to overcome the problems presented by state rules which have restrictions on fund use, required statutory earnings, minimum capitalizations, and strict rules concerning distribution of non-factual or inaccurate material. Obviously, many claims made in the course of a political campaign do not turn out to be factual. Some 28 states have merit review which gives too much discretion to the Commissioner of Securities in that State

concerning registration. In other words, these commissioners who are political appointees could determine a loan to a political group was not a good investment. There are no criteria for what a "good" investment is.

Moreover, treating political loans as securities requires all fund raisers to be licensed securities agents working for licensed securities brokers. Brokers and their agents are required, in Minnesota and most other states, to maintain lists of all "sales" and make them available for inspection by the Securities Commissioner and to determine if the investment is "suitable" for the "buyer". Thus, if one is well to do, one may support a political organization that is "risky" or not a traditional mainstream Republican or Democratic group. If too old, too young or not wealthy enough, the "investment" would likely be found "unsuitable". Those who wished to support a political group in this manner could not do so with anonymity. Supporters who wished to fund raise would have to pass examinations on securities laws to obtain agents licenses, i.e. face "super literacy" tests more onerous than those employed in the past to suppress racial and ethnic minorities. As noted in Petitioner's appeals briefs, the list of debilitating impairments goes on and on.

When one thinks of the concept of material disclosure under the securities laws being applied to political candidates, the mind boggles. Would a candidate have to disclose an extra marital affair if it might impact the success of his campaign? Would it be a material misstatement to claim the candidate would defeat his opponent if that was unlikely. The ramifications of applying securities concepts to first amendment organizations and political campaigns are staggering in their potential impact to core first amendment rights.

The first amendment aspects of this case allow for an analogy to be drawn from a recent Supreme Court decision which, although it did not deal with securities regulation, found that a section of the Federal Election Campaign Act was unconstitutional under certain circumstances. The case in question was the Federal Election Commission v. Massachusetts Citizens for Life, Inc., 107 S.Ct 616, 93 L.Ed2d 539, 55 U.S. LW 4067. This case concerned Section 316 of the Federal Election Campaign Act which prohibited corporations from using treasury funds to make an expenditure in connection with any election to any public office and required that any expenditure for such purpose be financed by voluntary contributions to a separate fund.Massachusetts Citizens for Life, like petitioners, was a non-profit, non-stock corporation. Its purpose was to foster respect for human life and defend the right to life of all human beings born and unborn through educational, political or other forms of activities (one of the goals of Petitioners herein). To further this activity it published newsletters that had been distributed to contributors and to non-contributors who expressed support for the organization. This court stated that the concern underlined in the regulation of corporate political activity - that organizations that amass great wealth in the economic marketplace not gain unfair advantage in the political marketplace - was absent with regard to Massachusetts Citizens for Life. The court opined:

> "This rationale for regulation is not compelling with respect to independent expenditures by appellee. Individuals who contribute to appellee are fully aware of its political purposes and, in fact, contribute precisely because they support those purposes. It is true that contributors may not be aware of the exact use to which his or her money ultimately may put or the specific candidate used to support. However, individuals contribute to a political organization as a more effective means of advocacy than spending money under their own direction..." at 4073.

Recently, this Court decided a similar situation involving a State's overprotective attitude towards its citizens. In the case of Meyer v. Grant, 108 S.Ct 1886 (1988), the State of Colorado had forbidden paid solicitors from circulating political petitions. The State's logic was that such paid solicitors would have more reason to falsify signatures. This Court held that such a ban was an infringement on the first amendment rights of citizens wishing to bring political questions in front of the voters. This Court stated:

> "We agree with the Court of Appeals conclusion that the statute trenches upon an area in which the importance of the first amendment protections is 'at its zenith'. For that reason, the burden that Colorado must overcome to justify this criminal law is well nigh insurmountable." at pg. 1894.

Petitioners in this case would make the same claim that because of the nature of their organizations and the purposes of those organizations that the first amendment protection in this case is at its highest and the State's actions are subject to exacting scrutiny.

As is apparent from the letter made part of the record in this case sent out by the Attorney General for the State of Minnesota, the ideas and beliefs of the Petitioner organizations and Lyndon LaRouche are not popular with the Minnesota Attorney General. He stated: "We must show the Nation that Minnesota will not tolerate the LaRouche fringe." Nor do Petitioners seem to be popular with other states. Notwithstanding that this securities issue is one of first impression, supporters and fund raisers have been charged with felony security law violations in Virginia, Missouri and New York. However, the use of the securities law to censor those ideas is improper. As this Court stated in NAACP v. Button, 371 U.S. 415, 83 S.Ct 328, 9 L.Ed2d 405 (1963):

> "The First Amendment is a value free provision whose protection is not dependent on the truth, popularity, or social utility of the ideas and beliefs which are offered."

It should be noted that supporters dissatisfied with repayment of their loans have other remedies available under Minnesota law. There are consumer protection statutes enforceable by the Attorney General and individuals, common law fraud causes of action, criminal fraud statutes and actions in debt available to aggrieved persons.

II. THE MINNESOTA COURT OF APPEALS HAS IMPROPERLY APPLIED MINNESOTA SECURITIES LAW TO INDEPENDENT DEMOCRATS FOR LAROUCHE, A CAMPAIGN ORGANIZATION REGULATED UNDER THE FEDERAL ELECTION COMMISSION IN CONFLICT WITH THE DECISIONS OF THIS COURT.

Respondent Independent Democrats for LaRouche's (IDL) loans should not fall within the purview of the Minnesota Securities Act because this organization was a campaign organization formed to aid Lyndon LaRouche in his campaign for the presidency of the United States. The Federal Election Campaign Act amendments of 1974 are an attempt by Congress to reform campaign expenditures and political contributions. This Act evidences a clear intent to preempt any State law regarding campaign expenditures and political contributions. To use the Minnesota Securities Law against Independent Democrats for LaRouche effectively circumvents the Federal Election scheme.

The Supreme Court outlined the various facts of federal preemption law in Louisiana Public Service Commission v. F.C.C., 106 S.Ct 1980, 1898-99 (1986):

> "The Supremacy Clause of Art. VI of the Constitution provides Congress with the power to preempt state law. Preemption occurs when Congress, in enacting a federal statute, expresses a clear intent to preempt state law, Jones v. Roth Packing Co, 430 U.S. 519, 97 S.Ct 1305, 51 L.Ed.2d 604 (1977), when there is outright or actual conflict between federal and state law, e.g., Free v. Bland, 369 U.S. 663, 82 S.Ct 1089, 8 L.Ed.2d 180 (1962), where compliance with both federal and state law is in effect physically impossible, Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 83 S.Ct 1210, 10 L.Ed.2d 248 (1963), where there is implicit in federal law a barrier to state regulation, Shaw v. Delta Air Lines, Inc., 463 U.S. 85 103 S.Ct 2890, 77 L.Ed.2d 490 (1983), where Congress has legislated comprehensively, thus, occupying an entire field of regulation and leaving no room for the states to supplement federal law, Rice v. Sante Fe Elevator Corp., 331 U.S. 218, 67 S.Ct 1146, 91 L.Ed. 1447 (1947), or where the state law stands as an obstacle to the accomplishment and execution of the full objectives of Congress. Hines v. Davidwitz, 312 U.S. 52, 61 S.Ct 399 85 L.Ed. 581 (1941). Preemption may result not only from action taken by Congress itself; a federal agency acting within the scope of its congressionally delegated authority may preempt state regulation. Fidelity Federal Savings & Loan Assn. v. De la Cuesta, 458 U.S. 141, 102 S.Ct 3014, 73 L.Ed.2d 664 (1982); Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691 (1984)."

The Federal Election Campaign Act Amendments of 1974 present an express preemption issue. As the Supreme Court stated in Silkwood v. Kerr-McGee Corp., 104 S.Ct 615, 621 (1984): "if Congress evidences an intent to occupy a given field, any state law falling within that field is preempted."

Further, when a federal statute unambiguously preempts certain state legislation, the statutory language is controlling and preemption takes place. Exxon Corp. v. Hunt, 106 S.Ct 1103, 1109 (1986); Aloha Airlines, Inc. v. Director of Taxation, 464 U.S. 7, 12 (1983).

The Federal Election Campaign Act Amendments of 1974, public law 93-443, 88 Stat. 1263, reprinted in 1974 U.S. Code Congressional and Administrative News, p. 1436, et. seq., contain three different provisions regarding preemption of state law. The first provision is contained in Section 104 of the Act. Section 104 reads as follows:

> "Sec. 104
> (a) The provisions of Chapter 29 of Title 18 United States Code, relating to elections and political activities, supersede and preempt any provision of state law with respect to election of federal office.
>
> (b) For purposes of this section, the terms "election", "federal office", and "state" have the meanings given them by section 591 of Title 18 United States Code."

The legislative history explaining this provision states:

> "Conference Substitute - The conference substitute is the same as the House amendment. The provisions of the conference substitute make it clear that the federal law occupies the field with respect to criminal sanctions relating to limitations on campaign expenditures, the sources of campaign funds used in federal races, the conduct of federal campaigns, and similar offenses, but does not affect the state's rights to prohibit false registration, voting fraud, theft of ballots, and similar offenses under state law."

Senate Report no. 93-689, reprinted in 1974 U.S. Code Congressional and Administrative News 5587, 5638.

There is a second preempting provision. Section 301 of the Federal Election Campaign Act Amendments of 1974, codified at 2 U.S.C. Section 453 provides:

> "The provisions of this Act, and of rules prescribed under this Act, supersede and preempt any provision of state law with respect to election to federal office."

This is very broad language. Its breadth is confirmed by the legislative history. The legislative history concerning this section of the law states:

> "Senate Bill:
> Section 213 of the Senate bill amended Section 403 of the Act, relating to effects on state law, to provide that the provisions of the Act preempt any provision of state law with respect to campaign for election to federal office.
>
> House Amendment:
> Section 301 of the House amendment amended Section 403 of the Act, relating to effect on state law, in essentially the same manner as the amendment made by Section 213 of the Senate Bill.
>
> Conference substitute:
> The conference substitute follows the House amendment. It is clear that the federal law occupies the field with respect to reporting and disclosure of political contributions to and expenditures by federal candidates and political committees, but does not affect state laws as to the manner of qualifying as a candidate, or the dates and places of elections."

Senate report #93-689, reprinted at 1974 U.S. Code Congressional and Administrative News 5587, 5668.

Both the plain meaning of the statute and the legislative history makes Congress' intent to preempt very clear. As

noted above, in such a case, preemption must be deemed to occur.

An attempt by the State of Minnesota to use their securities law to regulate an organization such as IDL which was formed to deal with the election of an individual to federal office, is a use of the law directly in contradiction to the Federal Act. The hearings officer in this matter has attempted to rule that the federal preemption only applies to election laws. The Federal Act specifically regulates loans to campaign committees. 2 U.S.C. Section 431(8); 11 CFR Section 100.7. Clearly, under these circumstances, the Minnesota Securities Act is operating as an election law and addresses an area specifically regulated by the Federal Act.

III. THE SANCTION IMPOSED BY THE ADMINISTRATIVE LAW JUDGE PRECLUDED THE PETITIONERS FROM CONTESTING A CEASE AND DESIST ORDER AND WAS IMPROPER IN THAT IT DEPRIVED PETITIONERS OF A FAIR AND IMPARTIAL HEARING AND INFRINGED UPON THEIR FIRST AMENDMENT RIGHTS.

On January 27, 1987 the Administrative Law Judge issued an order precluding Petitioners from introducing evidence contesting the last sentence of paragraphs 1, 2 and 7 of the State's Amended Cease and Desist Order. Paragraph 2 was the ultimate issue of the contested case in that it alleged that the promissory notes offered by Petitioners constituted securities within the meaning of the Minnesota Securities Act. Thus, Appellants were not able to present witnesses or evidence at a hearing to contest the State's allegations that the transactions involved in this matter constituted a sale of securities. The sanction order was based on the fact that the corporate

Petitioners had resisted throughout the course of the proceeding the States attempts to obtain a list of Petitioner's supporters, contributors and lenders. Petitioners resisted these attempts on the part of the State on first amendment and privacy grounds. Petitioners contended that the orders and subpoenas of the Minnesota Division of Securities inhibited Petitioners and their supporters respective rights of association, belief and freedom of speech as guaranteed by the United States Constitution under the First and Fourteenth Amendments. Further, Petitioners contended that supporters and contributors right of privacy under the United States and Minnesota Constitutions were being violated. Petitioners submitted John Doe and other affidavits from or addressing approximately 19 persons who had made loans to Petitioner's organizations. These affidavits indicated that these lenders and supporters did not wish their names revealed to government agencies for fear of harassment or retaliation. In the October 6th discovery order, the Administrative Law Judge recognized this fear on the part of Petitioner's supporters and acknowledged that a chilling effect caused by this fear was probable. At the beginning of the case, Petitioners had revealed seven names to the State (with the permission of those supporters) and the State had not even taken the trouble to interview all of those individuals.

First amendment rights are to be interpreted liberally. They are fundamental and occupy a preferred place in society. As this Court stated in NAACP v. Alabama, 357 U.S. 449, 78 S.Ct 1163, 2 L.Ed2d 1488 (1958):

> "Inviobility of privacy in group association may in many circumstances be indispensable to preservation of freedom of association, particularly where a group espouses dissident beliefs." at page 462.

There is no doubt that the overwhelming weight of authorities is to the effect that forced disclosure of first

amendment activities creates a chilling effect which must be balanced against the State's interest in obtaining that information. Australia/Eastern U.S.A. Shipping Conference v. U.S., 537 F.Supp 807 (1982). The State of Minnesota had received some seven names from Petitioners and had not bothered to contact even all of those individuals to make its case. Further, the State attempted to argue that a list of all Petitioner's supporters and lenders was needed in order to determine whether Petitioners could claim a limited offering exemption. Petitioners at all times during this case made it clear to the State that it did not wish to claim a limited offering exemption. The State's interest could not be compelling under these circumstances.

In the case of Federal Election Commission v. Hall-Tyner Election Campaign Committee, 678 F.2d 416 (2nd Cir., 1982), Judge Kaufman stated:

> "Anonymity has long been essential to uninhibited political activity in a democratic society. The secret ballot insures that no one must answer for the vote he cast. Confidentiality prevents the apprehension of reprisal that threatens to suppress the robust interchange of ideas at the core of the First Amendment's guarantee of free speech and protection of privacy and association. A society confident in its stability does not fear the voice of opposition. Indeed, unafraid of dissent, we recognize our ability to exhibit special indulgence to nurture the free expression of minority views. Realizing that mere identification with certain disfavored ideologies can result in harassment which may silence those voices, the Constitution protects private support of political associations."

Also,

> "Acknowledging the importance of fostering the existence of minority political parties, we must also recognize that such groups rarely have a firm financial foundation. If apprehension is bred in the mind of

> contributors to fringe organizations by fear that their support of an unpopular ideology will be revealed, they may cease to provide financial assistance. The resulting decrease in contributions may threaten the minority parties very existence. Society suffers from such a consequence because the free flow of ideas, the life blood of the body politic, is necesarily reduced. Accordingly, a nation dedicated to free thought and free expression cannot ignore the grave results of facially innocuous election requirements.
>
> The power of the government to repress dissent is substantial and can be exercised in a myriad of subtle ways. Privacy is an essential element of the right of association and the ability to express dissent effectively. As a result, removing the cloak of anonymity from a political committee by requiring it to disclose the names of those who purchase its publications, threatens important first amendment values. Such forced revelations would likely lead to 'vexatious inquiries' which consequently could instill in the public an unremitting fear of becoming linked with the unpopular or the unorthodox."

The view of the Minnesota Attorney General's Office concerning organizations associated actually or reputedly with Lyndon LaRouche is illustrated by the attached Appendix I. The State in this case had sufficient facts available through the testimony of parties to the transactions at issue and would have had further facts available had it taken the trouble to interview all seven of the people whose names were given to them by Petitioners. The further discovery of contributors and lenders was merely official curiosity and would expose Petitioner's sympathizers unnecessarily.

It is clear that in a situation such as this Petitioners could not comply with the State's discovery orders without waiving important constitutional rights. Such a refusal by Petitioners is not willful, nor is it done in bad faith. See Edgar v. Slaughter, 548 F.2d 770 (8th Cir., 1977) and Socite Internationale v.

Rogers, 357 U.S. 197, 78 S.Ct 1087, 2L.Ed2d, 1255 (1958). Petitioners even requested an interlocutory appeal. The State of Minnesota decisions have consistently held the factors to be considered in a sanctions manner are (1) the wilfullness of the failure to disclose; (2) the resulting prejudice; and (3) the harm to the truth seeking process if severe sanctions are imposed. Cornfeldt v. Tongen, 262 N.W.2d 684 (1977). It is clear in this case that the Petitioners tried to comply with the State's orders as best they could and still be consistent with the constitutional restraints they felt were present. Further, the harm imposed by the sanction was great. It, in effect, deprived Petitioners of the ability to present their case in front of the Hearings Officer. The State of Minnesota was in no way prejudiced by Petitioner's failure to reveal all of the names.

CONCLUSION

This writ request should be granted because this case presents a classic constitutional confrontation between the core freedom of individuals and groups whose viewpoints are not traditional and the more traditional mainstream political governmental authorities seeking to suppress dissident viewpoints. Treating loans to political associations as securities opens a veritable pandora's box of debilitating blows to the sanctity of the First Amendment. Numerous less restrictive alternatives are available to police areas of legitimate concern. These alternatives include a variety of civil and criminal remedies which do not intrude on the First Amendment yet effectively and fully address state interests. See Meyer v. Grant, 108 S.Ct 1886, 56 USLW 5616 (1988).

Permitting the states (there are 14 states with cease and desist orders pending against some or all of Petitioners) to impose securities regulation requirements on political associations and federal campaign committees creates an impermissible opportunity for of politically motivated suppression of both dissident and opposing political viewpoints. While efforts of securities commissioners are

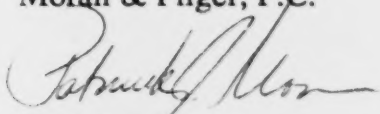
confined to suppressing these Petitioners at the moment, history demonstrates that the temptation to use this power will prove irresistible. The practice will spread if not ended now.

In this day and age, fund raising is critical to effective dissemination of viewpoints. Publication of newspapers, magazines, books and flyers on a national basis is expensive. Use of loans is a traditional method of political fund raising. That is why it was addressed by the Federal Act and by Federal Election Commission regulations. If it is a "security" for these Petitioners, it is one for all campaign committees. A loan could not issue unless registered as a security. A loan could only be solicited by a licensed agent who worked under the supervision of a licensed broker. If fund raising exceeded certain limits ($100,000 to $500,000), a prospectus or offering memorandum would be required in many states. The devastating impact of this ruling in the Minnesota Supreme Court is likely to be followed in Alaska, Maryland, Washington, Virginia, Missouri, Indiana, Illinois, New York, Massachusetts and elsewhere. There is a clear need to address this issue now.

The granting of this writ would be an important step towards clarifying the law as to the circumstances under which promissory notes constitute securities subject to regulation under state or federal securities acts.

Respectfully submitted,

Moran & Pilger, P.C.



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APPENDIX

STATE OF MINNESOTA

IN SUPREME COURT

C4-87-1952

Caucus Distributors, Inc., et al.,

Relators,

vs.

Commissioner of Commerce,

Respondent.

ORDER

Based upon all the files, records adn proceedings herein, It is hereby ordered that the petition of Caucus Distributors, Inc., Campaigner Publications, Inc. and Independent Democrats for La Rouche for further review be, and the same is, denied.

Dated 6-10-88

By the Court

(signed)

Chief Justice

STATE OF MINNESOTA
DEPARTMENT OF COMMERCE
COMMISSIONER OF COMMERCE

In the Matter of Caucus
Distributors, Inc., and
Campaigner Publications, Inc.,
New York Corporations, Independent
Democrats for LaRouche, an Unincorporated
Association, Ron Fredman, Ronald R. Bettag,
Paul Greenberg, and All Other Parties and
Organizations Acting in Concert with the
Named Respondent.

FINDINGS OF FACT, CONCLUSION OF LAW, AND ORDER

COM/S-86-047-JL
8-1005-698-2

The above-entitled matter came on for hearing before Administrative Law Judge Jon Lunde, on Monday, August 4, 1986 at the Office of Administrative Hearings in Minneapolis, Minnesota. Additional proceedings were held the following day. The hearings were held pursuant to an Order for Hearing, an Order Suspending Exemption issued by the undersigned on June 4, 1986, and an amended Cease and Desist Order, Notice of Right to Hearing and Order Suspending Exemption issued by Deputy Commissioner of Commerce James Miller on July 17, 1986.

Jerome Getz, Special Assistant Attorney General, 1100 Bremer Tower, Seventh Place and Minnesota Street, St. Paul,

Minnesota 55101, appeared on behalf of the Minnesota Department of Commerce (Department). Patrick Moran, Moran & Pilger, P.A., Attorneys at Law, 1221 Lamar Building, Suite 517, Houston, Texas 77010, appeared on behalf of each of the above-named organizations and individuals. The record closed on May 20, 1987.
Thereafter, on July 15, 1987 Administrative Law Judge Lunde issued his Findings of Fact, Conclusions and Recommendations to the undersigned. On July 20, 1987, the undersigned sent notice that exceptions and arguments should be filed with the Department of Commerce no later than August 12, 1987, and the Attorney General filed exceptions and argument on August 14, 1987.

Based upon an examination of the transcript and exhibits, and upon a review of all the briefs and all of the other records, files and proceedings herein, the undersigned makes the following:

FINDINGS OF FACT

1. Caucus Distributors, Inc., (Caucus) is a Not-For-Profit corporation incorporated under the laws of the State of New York. The Certificate of Incorporations its incorporators filed with the New York Department of State on April 5, 1982 reads in part as follows:

* * *

2. The corporation * * * is not formed for pecuniary profit or financial gain, [and] * * * no part of the assets, income or profit of the corporation is distributable to, or inures to the benefit of its members, directors or officers or any private person except to the extent permissible under the Not-For-Profit Corporation Law.

3. The purposes for which the corporation is formed are:

> To promote and encourage the political and [sic] ideas and beliefs fostered by the International Caucus of Labor Committees and other organizations advocating the same ideas and beliefs; to distribute to the general public, sell and obtain subscriptions to publications specifically dedicated to the political ideas and beliefs fostered by the International Caucus of Labor Committees and other organizations; to solicit membership for certain membership organizations associated with the publications distributed by the corporation consonant with the goals, purposes and programs of those organizations; to advertise and promote the publications distributed by the corporation; to engage the services of writers, reporters, editors, distributors, corporations, associations, partnerships and new agencies in furtherance of these purposes; ***

2. Campaigner Publications, Inc. (Campaigner) is a New York corporation.

3. Independent Democrats for LaRouche (IDL) is an unincorporated association and a political committee apparently recognized by the Federal Election Commission. Paul Greenberg is an authorized representative of IDL and is empowered to sign notes on its behalf.

4. At all times material to this case, Ron Fredman and Ronald R. Bettag worked for Caucus and solicited loans to Caucus, IDL and Campaigner by selling notes for them.

5. Ron Fredman, Ronald R. Bettag and Paul Greenberg are not and have never been licensed by the Department to sell

securities in the State of Minnesota. Likewise, Caucus, Campaigner, and IDL are not and never have been licensed by the Department to sell securities in the State of Minnesota.

6. Mary M. Mitchell, an 85-year-old widow, is a resident of Minneapolis, Minnesota. She has lived there since moving from Winona in 1938. Mitchell is a retired stenographer who has a high school education.

7. In July, 1984, while walking on the Mall near.Seventh and Nicollet in downtown Minneapolis, Mitchell was given a pamphlet pertaining to the presidential candidacy of Lyndon LaRouche. She told the man who gave her the pamphlet that she had seen LaRouche on television and liked what she saw. The man told her that if she gave him her name and telephone number someone would call her with more information about LaRouche. She gave him the information.

8. Approximately one week after her encounter on the Mall, Ron Fredman telephoned Mitchell from Chicago to talk to her about LaRouche, Caucus, Campaigner and IDL. Fredman told Mitchell about corruption in the world and the need for Americans to clean it up. He specifically mentioned drug trafficking in the Middle East and South America, the laundering of Mafia money by banks, the decline in American culture, and bank failures. He told Mitchell that some banks were shaky and that if the United States didn't pull together, everyone would go bankrupt. Fredman told Mitchell that LaRouche needed her help with these problems and he asked her for a contribution. She agreed to make a $25 contribution at that time, and he made arrangements for her to receive copies of "New Solidarity" and other publications.

9. During that initial telephone conversation, Fredman also asked Mitchell to help by making loans. Fredman told her

that she would receive a promissory note for any loans she made and that she could specify the interest rate and the term of the notes. Since she would get a promissory note and could specify the interest rate, Mitchell concluded that the loans would be similar to a banking transaction. Moreover, since LaRouche was "in the limelight", she concluded that she was not dealing with a fly-by-night operation that would skip the country, and that her loans would be a good investment. Therefore, she agreed to make a $15,000 loan at that time. In return, she was to receive two notes payable at the end of three years. One was to be made payable to her and her stepson, R. Keith Mitchell, in the principal amount of $10,000. The other was to be made payable to her and her sister-in-law, Mozell Hall, in the principal amount of $5,000. Fredman personally collected two checks in the aggregate amount of $15,000 from Mitchell at her home in Minneapolis early in July 1984. Later that month, two promissory notes were mailed to her in the aggregate principal sum of $15,000. The notes stated the payees, amounts, term and interest rate Fredman promised.

10. On September 3, 1984, Fredman called Mitchell again and asked her to loan $1,000 to IDL. She agreed to make a $1,000 loan to IDL for one year at ten percent interest. Following her conversation with Fredman, she mailed him a $1,000 check payable to IDL's order. A few days later, she received a promissory note signed by Paul Greenberg, as an authorized representative of IDL. The note was in the principal sum of $1,000, bore interest at the rate of ten percent, and was payable in one year. The note, and accumulated interest thereon, was paid by IDL in July 1986.

11. On or about September 17, 1984, Fredman telephoned Mitchell again to give her an update on the activities of the LaRouche organizations. At that time, he gave her more information on their efforts to eliminate drug traffic and related activities in the Middle East. In addition, he talked about a publication entitled "Dope, Incorporated" which one of the

organizational Respondents had published. During that telephone conversation, Mitchell agreed to make an additional $5,000 loan to Caucus for 90 days with interest at 15 percent. Immediately after her telephone conversation with Fredman, Mitchell mailed him a check payable to Caucus in that amount. A few days later, Mitchell received Caucus' promissory note incorporating the loan terms she and Fredman had discussed.

12. On or about November 26, 1984, Fredman called Mitchell to solicit another loan. During that conversation, Mitchell expressed regret for having made the initial $15,000 loan for a term of three years. He told her that if she returned the notes to him, he would issue two new notes which would mature in a year (on November 26, 1985). At that time, Fredman persuaded Mitchell to make an additional $10,000 loan to Caucus for six months. When Mitchell told Fredman she was getting 14 percent on a certificate of deposit with her bank, he said that Caucus would pay 16 percent on the loan.

13. On or about November 26, 1984, a $10,000 promissory note signed by Fredman for Caucus was mailed to Mitchell. It reflected a six-month term and a 16 percent interest rate as she and Fredman had agreed on November 26. At the same time, Mitchell was mailed two promissory notes replacing those which she had returned due to her dissatisfaction with their three-year maturity date. Exhibits 19 and 23. Those notes were signed by Fredman and Campaigner and reflected a one-year term and a 12 percent interest rate. The payees were the same as those in the notes originally issued.

14. Caucus' September 17, 1984 note -or $5,000 was due on December 17, 1984. On or about the due date, Fredman called Mitchell and told her that the note could not be paid because their assets had been frozen by a bank, and he asked her if she would accept a one-third partial payment. Although

Mitchell agreed that the bank's explanation for freezing Caucus' funds was "outlandish", she said she would like half of the note paid. Fredman said he would see if that could be done and call her back. Early in January, 1985, after Mitchell returned from a vacation, Fredman called her and asked if she would accept a new note covering Caucus' $5,000 loan to be payable in five monthly principal installments of $1,000 commencing May 1, 1985 and a lump sum interest payment on October 1, 1985. She agreed and a short time later received a promissory note from Caucus in the principal sum of $5,000. Exhibit 7. That note contained the payment terms she had agreed to accept and was signed by Fredman for Caucus.

15. In April 1985, Mitchell asked Fredman if the beneficiaries on Campaigner's November 26, 1984 notes could be changed. He said that could be done and they agreed that Campaigner's two notes (Exhibits 19 and 23) would be destroyed and that one new note would be issued in the principal amount of $15,000. Mitchell also agreed that the rate of interest could be reduced from 12 percent to 10 percent on the new note. Exhibit A. A short time later, a $15,000 note payable in one year with interests at 10 percent was mailed to her. Exhibit 24. Caucus was listed as the payor of that note and it was signed by Fredman. The note was dated April 16, 1985 rather than November 16, 1984. Mitchell did receive interest on the $15,000 loan between November 26, 1984 and April 16, 1985, did not agree to waive interest earned during that time, and did not authorize a change in the date of the two notes when they were rolled over and consolidated.

16. During the telephone conversation between Mitchell and Fredman on April 10, 1985, Mitchell agreed to make an additional loan to Caucus in the amount of $10,000. The loan was made in two separate payments to Caucus. A $6,000 payment was made by a check dated April 10, 1985 and a $4,000 payment was made to Caucus by a check dated April 26, 1985. On or about April 29, 1985, Caucus' $10,000

promissory note was mailed to Mitchell. The note, which was signed by Fredman, carried an interest rate of 10 percent and was payable in six months.

17. Apart from her loan to IDL, Mitchell loaned $40,000 to Caucus between July 1984 and April 29, 1985. As of November 21, 1985, only $2,000 had been repaid to her. A $1,000 payment was made late in April 1985, a $500 payment was made on November 6, 1985 and a $500 payment was made on September 30, 1985 (two checks).

18. During their telephone conversation in 1984 and 1985, Mitchell and Fredman primarily talked about Caucus, but he never explained his relationship to Caucus, Campaigner or IDL. In addition, he never told her how they would repay the loans, if they had solicited loans from other persons, or if they had repaid those loans in a timely fashion.

19. All of Mitchell's loans to the Respondents, except the $1,000 loan made to IDL, were made by check payable to Caucus. All the checks were presented for payment and paid by her bank. Mitchell did receive interest on the $15,000 loan between November 26, 1984 and April 16, 1985, did not agree to waive interest earned during that time, and did not authorize a change in the date of the two notes when they were rolled over and consolidated. All the loans we:- solicited by Fredman. Mitchell had no direct contact with Greenberg and had very limited contact with Bettag. Her only contact with Bettag occurred in 1985 after she became concerned about the repayment of her notes. Bettag told her that the LaRouche organizations stand behind their commitments and that notes were good investments. Bettag explained that money wasn't coming in as fast as they had expected, but that all their loans would be repaid and that her money was safe.

20. After the conversation with Bettag, Mitchell advised

family members about the loans she had made to the Respondents and the delinquencies that existed. Later, with their advice and input, she retained counsel and the Department was eventually informed of the transactions.

21. In later November of 1985, Joyce Rubenstein, a Caucus representative, telephoned Mitchell from New York to discuss her loans to Caucus. Rubenstein advised Mitchell that if she would make an additional $10,000 loan to Caucus she would be sure to get the rest of her money ($40,000) back. Based on these representations, Mitchell loaned Caucus another $10,000 for eight months at 12 percent. On November 29, 1985, Mitchell received confirmation from Caucus that the loan had been made under those terms. Confirmation was in a letter form. No note was issued as had been done in the past.

22. Mitchell considered all of her loans to the Respondents as investments, not unlike certificates of deposit that individuals can purchase from a bank. None of her loans were intended to be contributions and none of them were collateralized. Apart from IDL's note, most of the notes issued were notarized by .Bettag and most specifically stated that they could not be assigned, transferred or discounted. All of them were signed by Fredman.

23. In 1984 and 1985, the Respondents solicited loans from other Minnesota residents and from residents in other states including Illinois, Maryland, Alaska, Indiana, and Washington.

24. No individual employed by or representing the Respondents gave Mitchell any financial information regarding the organizational Respondents that she could use to determine their ability to repay the loans she made. She was not told how the Respondents would be able to repay her loans, where

the money used to repay her loans would come from, or what the risks of her investments were. Mitchell was not advised if Caucus was in default of its obligation to repay principal and interest to other investors or that one judgment had been entered against Caucus for failure to repay a loan when due. : Moreover, Mitchell was never advised that the Respondents were not licensed to sell securities in the State of Minnesota or that the notes were not registered as required by law. In fact, Fredman told Mitchell that the loans were legal.

BASED ON THE FOREGOING FINDINGS OF FACT, THE UNDERSIGNED MAKES THE FOLLOWING:

CONCLUSIONS OF LAW

1. That the Minnesota Commissioner of Commerce and the Administrative Law Judge have authority to consider the issues raised by the Commissioner's Cease and Desist Order and Order Suspending Exemption, as amended, under Minn. Stat. §§ 80A.21, 80A.15, subd. 3, and 14.50 (1984).

2. That the Department has complied with all releyant substantive and procedural requirements of law and rule and that the Respondents received proper and timely notice of the hearing and of the Commissioner's Orders.

3. That under Minn. Rule 1400.7300, subp. 5, the Department has the burden of proof to establish the statutory violations alleged by a preponderance of the evidence.

4. That the loans solicited by Ron Fredman and the notes issued by the organizational Respondents constituted offers and sale for purposes of Minn. Stat. § 80A.14, subd. 17 (1984).

5. That the promissory notes offered and sold by the Respondents in the state of Minnesota constitute securities for purposes of Minn. Stat. § 80A.14, subd. 18 (1984).

6. That the promissory notes offered and sold by the Respondents in the State of Minnesota were not registered with the Commissioner .prior to :or at the time of their offer of sale as required by Minn. Stat. § 80A.08 (1984).

7. That the Respondent Ron Fredman violated Minn. Stat. § 80A.014, subd. 1, by transacting business in this State as an agent without a license to do so.

8. That the organizational Respondents violated Minn. Stat. § 80A.04, subd. 2, by employing Ron Fredman as their agent.

9. That in connection with the sale of promissory notes to Mary Mitchell, the Respondents Ron Fredman and Ronald R. Bettag failed to state material facts necessary in order to make statements that were made not misleading, contrary to Minn. Stat. § 80A.04, clause (b) (1984), by failing to disclose financial information which could have been used to determine the organizational Respondents. ability to repay the notes when due and by failing to advise Mitchell that none of the Respondents were licensed to sell securities in the State of Minnesota and that the promissory notes were not registered pursuant to the Minnesota Securities Act.

10. That the Cease and Desist Order proposed by the Commissioner is in the public interest and should be issued.

11. That under Minn. Stat. § 80A.15, subd. 4, the Respondents have the burden of proving any exemption claimed under Minn. Stat. § 80A.Ol to 80A.31 or any exception from a definition contained therein.

12. That the Respondents have failed to establish that the promissory notes they sold are subject to any exemption or exception.

13. That the Respondent Ron Fredman fraudulently misdated one of the promissory notes issued to Mitchell in violation of Minn. Stat. § 80A.Ol, clause (c) (1984).

14. That the Respondent Ron Fredman did not violate Minn. Stat. § 80A.Ol, clause (c) by telling Mitchell that some banks were failing.

BASED UPON THE FOREGOING CONCLUSIONS OF LAW, THE UNDERSIGNED MAKES THE FOLLOWING:

ORDER

1. That Respondent shall cease and desist from offering or selling any security in Minnesota without filing said security pursuant to Minn. Stat. ch. 80A, or without obtaining an opinion letter from the Department of Commerce that said security is exempt from filing.

2. That Respondents shall cease and desist from offering or selling any promissory notes or other debt instruments without filing said instruments pursuant to Chapter 80A, or without obtaining an opinion letter from the Department of Commerce that the instrument need not be filed.

Dated: Sept. 3, 1987

MICHAEL A..HATCH
Commissioner of Commerce
State of Minnesota
Department of Commerce

500 Metro Square Building
Seventh & Robert Streets
St. Paul, Minnesota 55101

State of Minnesota

In Court of Appeals

C4-87-1952
Department of Commerce
Randall, Judge

CAUCUS DISTRIBUTORS, INC.,
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ET AL.,
FULLER & FINNEY
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PATRICK J. MORAN
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Relators,

V

COMMISSIONER OF COMMERCE,
HUBERT H. HUMPHREY, III
ATTORNEY GENERAL

JEROME L. GETZ
SPEC. ASST. ATTORNEY GENERAL
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7TH PLACE & MINNESOTA STREET

ST. PAUL, MN 55101
Respondent.

Filed April 5, 1988
Office of Appellate Courts

SYLLABUS

1 A discovery sanction that precluded relators from contesting some of respondent's allegations did not impermissibly deprive relators of an opportunity to be heard. The sanction was for good cause and within the discretion of the Administrative Law Judge (ALJ).

2. The factual findings of the Commissioner were supported by substantial evidence.

3. The promissory notes relators issued constituted securities under Minn. Stat. § 80A.14.

4. The Federal Election Campaign Act does not preempt regulation of the issuance of securities by relator Independent Democrats for LaRouche.

5. Minnesota Security Laws do not impermissibly infringe on relators' first amendment rights to freedom of association.

6. Improper portions of relator's brief and appendix are stricken.

Affirmed.

Heard, considered and decided by Randall, Presiding Judge, Lansing, Judge, and Mulally,* Judge.

OPINION

RANDALL, Judge

This matter is before us on writ for certiorari to review a decision of the Commissioner of Commerce. The Commissioner found promissory notes relators offered and sold in exchange for loans were unlicensed securities. The Commissioner ordered relators to cease offering or selling unfiled promissory notes or debt instruments without obtaining an opinion letter from the department of commerce. This appeal is from the Commissioner's order. We affirm.

FACTS

Relators Caucus Distributors, Inc. (CDI) and Campaigner Publications, Inc. (CPI) are New York corporations. Independent Democrats for LaRouche (IDL) is an unincorporated association.

MM, an 85 year old widow, was the only witness to testify at the hearing. According to MM's testimony, her first contact with respondents was in July 1984. MM was downtown Minneapolis, when she saw an individual passing

* Acting as judge of the Court of Appels by appointment pursuant to Minn. Const. Art. 6,§2.

out pamphlets. MM took a pamphlet and found it discussed Lyndon LaRouche. She heard LaRouche on television a few days earlier, and she told the pamphleteer she liked LaRouche and his views. MM gave the pamphleteer her telephone number so someone could call her and talk about LaRouche.

About a week later, MM received a telephone call from Ron Fredman of the Chicago office. Fredman told MM that the organization could use her help in its efforts to cut down on dope pushing in the Middle East and other places. He also mentioned incidents of banks closing, a matter of which MM was already aware through various newspaper articles.

Fredman asked MM to loan money to the LaRouche organization. MM testified Fredman told her she would get a promissory note, specifying the interest rate and maturity date, and MM said she "thought it was just like something you would give to a bank." In return for a $15,000 three-year loan, MM received two notes, one for $10,000 and another for $5,000.[1] On September 3, 1984, MM made out a check for $1000, payable to IDL. On the bottom of the check, MM made the notation: "1-yr. _____

April 16, 1985, to replace one note for $5000 and one note for $10,000, which had been made out for three years loan at 10%."[2] Shortly after MM mailed the check, she received a note from IDL, signed by Paul Greenberg. Relators stipulate that this was a valid loan, and that Greenberg was authorized to sign the note.

[1] A 12-month, $15,000 note was issued by Caucus Distributors

[2] The loan was paid off, together with interest.

After receiving another telephone call from Fredman, MM made out a check to CDI for $5000. On the bottom of the check, MM wrote: "90-day loan, 15 percent annual rate." MM received a note from CDI in early 1985, after Fredman informed her she could not be repaid within the 90-day period.

About November 26, 1984, MM made another loan to COI for $10,000, "for the same reason that [she] made the other ones. [She] thought it was a good investment * * *." MM received a six-month promissory note dated November 26, 1984, signed by Fredman for CDI in the amount of $10,000, with interest at 16%. Fredman offered her 16% when she told him she had a certificate of deposit (CO) at 14%.

In April 1985, Mr. Fredman called MM and asked to borrow more money from her. MM sent CDI one check for $4000 and another for $6000. She received a $10,000 promissory note at 10% interest from CDI, signed by Fredman. In the fall of 1985, appellant received three checks from CDI, totalling $1000, as partial loan repayment. MM testified she never believed she would not be timely repaid on the notes. She testified she was not informed that CDI was borrowing significant amounts of money from other persons. She did not know that CDI, CPI or IDL had failed to make timely payments on notes issued to other persons. MM did not know that other lenders had not been repaid and had obtained judgments against CDI.

In November 1985, Joyce Rubenstein, from CDI's New York office, telephoned MM, informing her that if she made an additional loan to CDI, the $40,000 total loans would be repaid. When she sent the check to CDI, MM received a letter acknowledging receipt of the loan.

On October 6, 1986, the ALJ issued a discovery order, requiring relators to provide a list of persons who made loans

to relators after September 1, 1983. Relators resisted on the grounds that the names of lenders to LaRouche's campaign were privileged information, and that requirement of their disclosure would somehow interfere with the first amendment right of freedom of association of CDI and its lenders.

The ALJ gave relators an alternative solution. Each relator could provide the ALJ with a comprehensive list of persons who had made loans. The ALJ would provide respondent with thirty names, chosen at random from each list, and respondent could then request additional information about the individuals chosen. The ALJ indicated that the information would be subject to a protective order providing for the confidentiality of the information, and for the return to relators of all information after a final decision was reached.

Relators deliberately did not comply with either option offered by the discovery order, continuing to claim the lists were privileged. Respondents moved for the imposition of sanctions. The ALJ denied the motion, but reaffirmed its prior order and again directed relators to comply with discovery. Relators again informed the ALJ of their decision not to comply with any discovery order. The ALJ then entered an order precluding relators from contesting portions of respondent's amended cease and desist order.

After considering the evidence, and consistent with the ALJ's recommendation, the Commissioner found that relators offered and sold unregistered securities in Minnesota, contrary to the requirement of Minn. Stat. § 80A.08, and ordered relators to cease and desist selling unfiled securities in Minnesota without obtaining an opinion letter from the department of commerce.

ISSUES

1. Did discovery sanctions improperly deprive relators of a right to be heard?

2. Were the factual findings of the Commissioner supported by substantial evidence?

3. Do the promissory notes issued by relators constitute securities under Minn. Stat. § 80A.14?

4. Does IDL constitute a presidential campaign organization, the regulation of which is preempted by the Federal Election Campaign Act?

5. Are relators' fund-raising activities protected by the first amendment?

6. Should materials in relators' brief be stricken?

ANALYSIS

I

DISCOVERY SANCTIONS

Relators contend they had a right to protect their lists of supporters and contributors on first and fourteenth amendment and privacy grounds. They assert that the order requiring disclosure of their membership violated their supporters' rights to free association and speech.

The compelled disclosure of an individual's affiliation with an organization may, standing alone, constitute an intrusion into the first amendment rights of privacy of association and

belief. Jones v. Unknown Agents of the Federal Election Commission, 613 F.2d 864, 874 (D.C. Cir. 1979)(discussing NÅACP v. Alabama, 357 U.S. 449 (1958)).

> [A] court must be particularly mindful of potential damage to associational interests when enforcing a subpoena against minor political parties and their members.

Federal Election Commission v. The LaRouche Campaign, 644 F.Supp. 120, 123 (S.D.N.Y. 1986)(citing Buckley v. Valeo, 424 U.S. 1, 71 (1976)).

However, governmental interests underlying the disclosure provisions of the Federal Election Campaign Act may outweigh the possible harm to the associational rights of members of minor political parties. See NAACP, 357 U.S. at 463.

The state's security laws are aimed at

> speculative schemes having no more basis than so many feet of blue sky, * * * and * * * [they are] intended to put a stop to the sale of shares in visionary oil wells, nonexistent gold mines and other "get-rich-quick" schemes calculated to despoil credulous individuals of their savings. It is a proper and needful exercise of the police power of the state and should not be given a narrow construction * * *. The commission * * * has the power, in making its investigation, to compel a full disclosure of the facts upon which to base an intelligent judgment.

State v. Gopher Tire & Rubber Co., 146 Minn. 52, 55, 177 N.W. 937, 938 (1920). This governmental interest is sufficiently compelling to outweigh the claimed infringement

by relators on their right of association with their contributors.

In LaRouche Campaign, the Federal Election Commission (FEC) sought information to determine whether the LaRouche Campaign had reported false information about contributions and loans. The court concluded that the state's interest was sufficiently compelling to require disclosure of solicitors and contributors. LaRouche Campaign, 644 F.Supp. at 122. The information that could be requested by the FEC included identification of officers, directors and other members insofar as they related to persons responsible for soliciting contributions, and all bank records pertaining to loans and contributions.

Here, the information requested is even less intrusive. The discovery order did not require disclosure of the names of persons soliciting loans, officers, directors, employees and volunteers unless the lists furnished had fewer than 25 names.

Respondents claim they were prejudiced by relators' failure to provide the list. We agree. Relators point out they provided respondent with seven names. However, relators' disclosure of seven names selected by relators did not adequately comply with the order. The ALJ correctly found that relators' failure to provide the required information deprived respondent of the opportunity to prove its case, particularly to prove the instruments were securities. The sanction was appropriate.

II

EVIDENCE TO SUPPORT FINDINGS OF FACT

Decisions of administrative agencies enjoy a presumption of correctness, and deference should be shown by courts to the agency's expertise and special knowledge in its field of

technical training, education, and experience. Reserve Mining Co. v. Herbst, 256 N.W.2d 808, 824 (Minn. 1977). This court must decide whether findings of fact are unsupported by substantial evidence. Id. at 827; Minnesota Administrative Procedure Act, Minn. Stat. § 15.0425 (1984).

Relators claim some of the Commissioner's findings of fact were not supported by the evidence. MM did not testify that Bettag, a consultant for relators, solicited loans from her. Relators claim there was no evidence Bettag had any role in soliciting loans.

However, respondent alleged that Bettag solicited loans. Relators' failure to comply with the ALJ's discovery order deprived respondent of the opportunity to prove this allegation. The ALJ's sanction for failure to comply with discovery precluded relators from contesting, among other things, respondent's claim that Bettag offered or sold promissory notes to persons in Minnesota. Since we affirm the discovery sanctions, we hold the Commissioner's finding was proper.

Relators claim the Commissioner's finding #18 constituted an abuse of discretion:

> During their telephone conversation in 1984 and 1985, [MM] and Fredman primarily talked about Caucus, but he never explained his relationship to Caucus, Campaigner or IOL. In addition, he never told her how they would repay the loans, if they had solicited loans from other persons, or if they had repaid those loans in a timely fashion.

Relators contend that it was unreasonable to assume MM did not realize that other lenders made loans to relators. The contested finding was that relators never told MM how the loans were to be paid, or about other loans or inability to make

other loan payments. That finding is supported by MM's testimony that Fredman never discussed with her how CDI would repay the loans, that COI was borrowing significant amounts of money from other persons, or that CDI had failed to make timely repayment on notes CDI had issued to other persons. She testified no one connected with CPI, IDL or CDI told her that any of those organizations had failed to make timely payments on loans to other persons.

Relators contend there was inadequate evidence to support finding #22, that MM "considered all of her loans to [relators] as investments, not unlike certificates of deposit * * *." When asked why she made a particular loan to CDI, MM testified: "[F]or the same reason that I made the other ones. I thought it was a good investment on there." MM testified Fredman offered her a note at 16% when she told him she had money invested in a CO at 14%. MM testified that she has quite a few CD's, and thought of them and bank accounts as investments. MM testified

> as long as he told me I could give a promissory note and specify the interest and when I would get repaid, I thought it was just like something you would give to a bank. * * * I said, "Well, if it's just a loan for a year or so, I could put it in the bank anyhow, so he could have it."

MM's testimony supports the finding.

III

SECURITIES

The Commissioner found that "the promissory notes offered and sold by [relators] in the State of Minnesota constitute securities for purposes of Minn. Stat. § 80A.14,

subd. 18 (1984)." The statute includes in its definition of "security:"

> any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest * * *.

Id. In a judicial or administrative proceeding under Minn. Stat. §§ 80A.01-.31, the burden of proving an exemption or an exception from a definition is upon the person claiming the exemption or exception. Minn. Stat. § 80A.15, subd. 4 (1984).

Both parties agree there is no applicable Minnesota caselaw defining security in a context similar to the notes at issue here. However, they agree that appropriate analysis would be under federal law interpreting the Securities Act of 1933, 15 U.S.C. §§ 77a-77bbbb, and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk.

Relators point out that the term "security" has the meaning given to it in the statute unless the context requires otherwise. Minn. Stat. § 80A.14, subd. 1 (1984). Relators contend that viewed in the context of the transaction, its notes are not securities within the definition of Minn. Stat. § 80A.14. Respondent agrees that it would be inappropriate to consider all notes securities, but claims the Commissioner properly found the notes at issue here to be securities.

Under a literal application of Minn. Stat. 80A.14, subd. 18, which specifically refers to notes as securities, the promissory notes would be securities. In Landreth Timber Co. v. Landreth, _ U.S. _, 105 S.Ct. 2297 (1985), the Supreme Court found instruments bearing the name and the usual characteristics of stock had to be treated as a security under the plain meaning of the statutory definition.

A literal interpretation is, however, inappropriate for the

term "note," which

> may now be viewed as a relatively broad term that encompasses instruments with widely varying characteristics, depending on whether issued in a consumer context, as commercial paper, or in some other investment context.

Id. at __, 105 S.Ct. at 2306.

Some courts have applied an investment contract analysis to determine whether a document is a security. In Securities & Exchange Commission v. W.J. Howey Co., 328 U.S. 293 (1946), the Supreme Court defined an investment contract, a security under the federal act, as:

> a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed by the enterprise.

Id. at 298-99. See also Gopher Tire, 146 Minn. at 56, 177 N.W. at 938 ("investment contract" found to mean contract or scheme for "placing of capital or laying out of money in a way intended to secure income or profit from its employment").

The Howey test has been applied to documents similar to the notes issued by relators. See Securities & Exchange Commission v. World Radio Mission, Inc., 544 F.2d 535 (1st Cir. 1976). World Radio Mission was a religious organization which raised funds by selling interest-bearing notes. The court found the documents were securities, both within the plain meaning of the statute and under the investment contract analysis, as applied in United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975). Id. at 852. Several federal

courts have rejected the Howey test, however. See Daily v. Morgan, 701 F.2d 496 (5th Cir. 1983); Exchange National Bank of Chicago v. Touche Ross & Co., 544 F.2d 1126 (2d Cir. 1976).

Relators contend the courts must look for the characteristics of an investment, i.e. "the expectation of profit based upon the entrepreneurial or managerial efforts of others." See Great Western Bank & Trust v. Kotz, 532 F.2d 1252 (9th Cir. 1976).

> To determine whether the transaction under review involves an "investment" in return for "securities" within the meaning of the securities laws, we analyze the nature and degree of risk accompanying the transaction to the party providing the funds. * * * The inquiry is whether the funding party invested "risk capital."

Id. at 1256-57 (citations omitted). The Kotz court found the ultimate inquiry to be whether the lender, a bank that received an unsecured note in exchange for a loan, contributed "risk capital" subject to the entrepreneurial or managerial efforts of the issuer of the note. Id. at 1257.

Relators argue MM made the loans with only an expectation of a set rate of interest not contingent upon the managerial or entrepreneurial efforts of relators, and therefore the loans are not securities. See Union Planters National Bank of Memphis v. Commercial Credit Business Loans, Inc., 651 F.2d 1174, 1185 (6th Cir. 1981)(loan participation purchased by bank did not constitute security, where bank considered transaction a loan, not an investment, the existence of collateral strongly suggested a commercial loan, and the interest payments were to be made from the efforts of a third party).

Here, the notes are securities under the Kotz test. MM's loans to relators were not collateralized; the loans made to MM

and to other individuals were not isolated transactions, but part of a general offering; and the notes were not short-term demand notes. This case can be distinguished from Union Planters, in that the ability to repay the loan and interest was directly dependent on the fund-raising efforts of relators, and not upon the managerial or entrepreneurial efforts of some third party.

Among the factors to consider when determining whether the notes were purchased as an investment or as a commercial loan are whether the notes were personal promissory notes issued by a private party; whether the notes were offered to the public; whether the issuer is the person bringing the claim; and whether the notes were procured in the solicitation of venture capital. See Lino v. City Investing Co., 487 F.2d 689, 694-95 (3d Cir. 1973).

Relators contend that MM did not make an investment because she expected to get back only her principal plus interest, and did not expect to share in any profits of enterprises conducted by relators. MM risked the loss of her capital in return for loans at an interest rate up to two percentage points above the rate she was receiving on her CD.

The following factors weigh in favor of finding the notes are securities under the commercial/investment dichotomy test:

1 MM is not a financial institution or commercial lender in the business of making loans to private parties;

2 The notes Were not issued in connection with consumer installment transaction or real estate purchase;

3 The notes were not collateralized;

4 The sale took place outside the normal market for notes and commercial paper;

5 The sales to MM took place as part of a broader solicitation of loans from members of the public;

6 MM considered the notes an investment;[3]

7 The notes are securities within the plain meaning of the statute .....

Relators point out that MM thought of the notes like certificates of deposit. Certificates of deposit issued by federally regulated banks are not securities. Marine Bank v. Weaver, 455 U.S. 551, 559 (1982). However, relators ignore the Supreme Court's reasoning:

> It is unnecessary to subject issuers of bank certificates of deposit to liability under the antifraud provisions of the federal securities laws since the holders of bank certificates of deposit are abundantly protected under the federal banking laws.

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[3] She was unwilling to make contributions in excess of $25 to appellants, but was prevailed upon to make substantial loans ($40,000), by promises of higher interest, including at one point interest two percentage points higher than interest she was currently receiving on a CD.

Id. The certificate of deposit analogy is not applicable here. MM and other lenders do not benefit from the protection of federal or state banking laws. An important consideration is that the purpose of the securities law is to protect members of the public from fraud and imposition. Gopher Tire, 146 Minn. at 55, 177 N.W. 938; see also State v. Investors Security Corp., 297 Minn. 1, 8, 209 N.W.2d 405, 409 (1973)(in accordance with an expansive view of our securities statutes, there has been a consistent broadening of the coverage of these statutes in Minnesota). We find, unequivocally, that this policy is furthered by our holding here that the Commissioner correctly found these notes to be securities under Minn. Stat. §80A.14 (1984) and subject to regulation by the State of Minnesota.

IV

FEDERAL PREEMPTION

Relators point out that state law may be preempted where congress enacts federal statutes with the clear intent of preempting state law. See Silkwood v. Kerr-McGee Corp., 464 U.S. 238, 248 (1984). Generally, a federal act does not supersede the police power of the state unless that was the clear and manifest purpose of Congress. Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977)(quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)). The federal-state balance will not be disturbed unintentionally by Congress or unnecessarily by the courts. See id. The test is whether, in the relationship between state and federal law as applied, the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." Hines v. Davidowitz, 312 U.S. 52, 67 (1941).

Respondent argues that Congress did not intend to preempt laws of general application outside the area of election, that

there is no conflict between the federal election laws and state law, and that compliance with one does not preclude compliance with the other. We agree that Minnesota security laws, as applied here to protect Minnesota residents, do not conflict with the intent of the federal election laws.

Relators would have this court hold that the federal laws relating to elections and political activities supersede and preempt any state law provision with respect to federal office, giving appellants absolute immunity from state law simply because LaRouche has aspirations to federal office. We decline to do so.

V

FIRST AMENDMENT ARGUMENTS

Relators argue that because they are political organizations, the first amendment protects them from application of state regulation. See generally Federal Election Commission v. Massachusetts Citizens for Life, Inc., _ U.S. _, 107 S.Ct. 616 (1986)(federal statute restricting independent spending unconstitutionally infringed on free speech without compelling justification). However, the bare claim of a first amendment interest does not insulate behavior from responsible judicial scrutiny. The state has an interest in protecting citizens from abusive practices in solicitation of funds for charity, even when the charitable Organization has a purpose protected by the first amendment. See Cantwell v. Connecticut, 310 U.S. 296, 306 (1940).

In World Radio Mission, notes made in exchange for loans to a religious organization were found to be securities. World Radio Mission asserted first amendment freedom of religion rights. The First Circuit Court of Appeals found that World Radio did not solicit contributions, but stressed the security of

investment. World Radio Mission, 544 F.2d at 538-39. The court pointed out the 12% interest rate "suggests defendants' investors were moved by something more than a donative spirit." Id. at 539. Having solicited funds on economic grounds, the court found, World Radio could not claim first amendment protection. MM, by her own uncontradicted testimony, stated she was induced, not by LaRouche's oratory or his political platform, but by high interest rates, to lend the money.

Similarly, relators here were not engaging in an activity protected by the first amendment when they issued promissory notes in exchange for loans. As in World Radio Mission, MM was motivated by "something more than a donative spirit." MM's testimony supports the Commissioner's finding that MM considered the loans investments and did not intend to make contributions. As purveyors of these "investments," relators cannot claim first amendment protection shields them from reasonable state regulation and reasonable scrutiny by the courts.

VI

STRIKING OF APPENDIX

Respondent requests this court to strike from the appendix a copy of a loan repayment agreement of the Ronald Reagan Congressional Victory Fund. Appellant claims this is the sort of thing to which MM referred when she said

> money is lent to Democrats, Republicans right along, and then they pay it when they get it. Where they get it from or how they arrange it, I don't know about it.

The record is devoid of evidence that MM had ever seen the victory fund document, and thus no evidence exists that she either relied on it or compared the notes in question to that

"loan repayment agreement." Additionally, the document was not introduced at trial. Portions of an appendix that were not before the trial court are not properly before this court. See State v. Edmison, 373 N.W.2d 639, 640 (Minn. Ct. App. 1985), reviewed and remanded on other grounds, 379 N.W.2d 85 (Minn. 1985).

Respondent objects to other portions of relators' brief containing information not in evidence. For instance, relators' brief refers to fund-raising activities of Republicans. Relators argue that such activities were overlooked, and that they are the victims of selective enforcement against minority political groups. The record does not support this accusation; this issue was not briefed, raised and argued to the ALJ, and will not considered on appeal.

Respondent also challenges a statement in relator's brief alleging some states received lists of lenders from Virginia or the federal authorities, and that it was probable Minnesota also received a list of Minnesota residents who ere lenders. Relators inferred from this claim that the discovery order they resisted was therefore unnecessary. Relators admit that this information was not in evidence, but assert it is common knowledge, and assert it is common knowledge, and assert these statements were never refuted. The statement that Minnesota "may have" received such a list is, by its phrasing, speculative, and , without more, we do not consider it. We grant respondent's motion to strike portions of relators' appendix. We note that our decision to strike these relatively immaterial portions has no bearing on our disposition of the issues in this case.

DECISI0N

The ALJ's discovery sanctions did not impermissibly deprive relators of the opportunity to present issues and argue

their case. The factual findings of the ALJ are supported by substantial evidence. The promissory notes relators issued constitute securities under Minn. Stat. §80A.14. The Federal Election Campaign Act does not preempt regulation of the issuance of securities by relator Independent Democrats for LaRouche. Minnesota security laws, as applied to relators fund raising activities, do not impermissibly infringe on relator's first amendment right of association. Portions of relators' brief and appendix are stricken.

Affirmed.

Blue Sky Law

(3) the security registered or sought to be registered is the subject of an administrative stop order or similar order or a permanent or temporary injunction of any court of competent jurisdiction entered under any other federal or state act applicable to the offering; but (i) the commissioner may not institute a proceeding against an effective registration statement under this clause more than one year from the date of the order or injunction relied on, and (ii) may not enter an order under this clause on the basis of an order or injunction entered under any other state act unless that order or injunction was based on facts which would currently constitute a ground for a stop order under this section;

(4) the issuer's enterprise or method of business includes or would include activities which are illegal where performed;

(5) the offering has worked or tended to work a fraud upon purchasers or would so operate;

(6) except with respect to securities which are being registered by notification, the terms of the securities are unfair and inequitable; provided, however, that the commissioner may not determine that an offering is unfair and inequitable solely on the grounds that the securities are to be sold at an excessive price where the offering price has been determined by arms length negotiation between nonaffiliated parties. The selling price of any security being sold by a broker-dealer licensed in this state shall be presumed to have been determined by arms length negotiation;

(7) when a security is sought to be registered by coordination there has been a failure to comply with the undertaking required by section 80A.10, subdivision 2, clause (d);

(8) the applicant or registrant has failed to pay the proper filing fee; but the commissioner may enter only a denial order under this clause and he shall vacate any such order when the deficiency has been corrected; or

(9) the offering of securities sought to be registered is not firmly underwritten and (i) the minimum amount of proceeds from the sale of the securities is not more than $500,000, and (ii) the maximum amount of proceeds is more than 200 percent of the minimum amount of proceeds required to go forward with the offering.

The commissioner may not institute a stop order proceeding against an effective registration statement solely on the basis of a fact or transaction known to him when the registration statement became effective unless the proceeding is instituted within the next 30 days.

Subd. 2. The commissioner may issue an order requiring the person for whom a registration was made to show cause why the registration should not be revoked. The order shall not b calculated to give reasonable notice of the time and place for hearing thereon, and shall state the reasons for the issuance of the order. The commissioner may by order summarily suspend a registration pending final determination of an order to show cause. a hearing on the merits shall be held within 30 days of the issuance of the order or suspension. All hearings shall be conducted in accordance with the provisions of chapter 14 [Administrative Procedure]. After the hearing, the

commissioner shall enter an order making such disposition of the matter as the facts require. If the person for whom the registration was made fails to appear at a hearing of which he has been duly notified, such person shall be deemed in default and the proceeding may be determined against the person upon consideration of the order to show cause, the allegations of which may be deemed to be true. The commissioner may adopt rules of procedure concerning all proceedings conducted pursuant to this subdivision.

[¶33,114]

Sec.80A14.Definitions. Subdivision 1. *Terms*. When used in sections 80A.01 to 80A.31, the terms defined in this section have the meanings given them unless the context otherwise requires.

Subd.2 *Affiliate*. "Affiliate" of another person means any person directly or indirectly controlling, controlled by, or under common control with the other person.

Subd. 3 *Agent*. "Agent" means any individual other than a broker-dealer who represents a broker-dealer or issuer in effecting or attempting to effect purchases or sales or securities. "Agent" does not include an individual who represents an issuer in:

(1) effecting transactions in a security exempted by section 80A.15, subdivision 1;

(2) effecting transactions exempted by section 80A.15, subdivision 2;

(3) effecting transactions with existing employees, partners or directors of the issuer if no commission or other...

subdivision of a government or any other entity.

Subd. 16 *Purchasing for investment.* "Purchasing for investment" means a purchase made for investment and not for the purpose of resale. In determining whether securities have been purchased for investment, the length of the period for which the securities are held will be one of the factors considered. Securities held fr two years after their purchase shall be conclusively deemed to have been purchased for investment.

Subd. 17. *Sale, sell.* (1) "Sale" or "sell" includes every contract of sale of , contract to sell, or disposition of , a security or interest in a security for value.

(2)"Offer" or "offer to sell" includes every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value.

(3) Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing is considered to constitute part of the subject of the purchase and to have bee offered and sold for value.

(4) A purported gift of assessable stock is considered to involve an offer and sale.

(5) Every sale or offer of a warrant or right to purchase or subscribe to another security of the same or another issuer, as well as every sale or offer of a security which gives the holder a present or future right or privilege to convert into another security of the same or another issuer, is considered to include an offer of the other security.

(6) The terms defined in this subdivision do not include (i) any bona fide pledge or loans; (ii) any stock dividend, whether the corporation distributing the dividend is the issuer of the stock or not.

Subd. 18. *Security*. (a) "Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit sharing agreement; collateral trust certificate; preorganization certificate or subscription; transferable shares; investment contract; investment metal contract or investment gem contract; voting trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil gas or mining right, title or lease or in payments out of production under the right, title or lease; or, in general, any interest or instrument commonly known as a security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for guarantee of , or warrant or right to subscribe to or purchase, any of the foregoing. "Security" does not include:

(1) any insurance or endowment policy or annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or for some other specified period; or

(2) stock of a closely-held corporation offered or sold pursuant to a transaction in which 100 percent of the stock of that corporation is sold as a means to effect the sale of the business of the corporation if the transaction has been negotiated on behalf of all purchasers, and if all purchasers have access to inside information regarding the corporation before consummating the transaction.

(b) A security that is offered and sold pursuant to section 4(5) of the Securities Act of 1933 or that is a "mortgage related security" (as defined in section 3(a)(41) of the Securities

Exchange act of 1934) is not a security exempt from registration under section 80A.15, subdivision 1 paragraph (a), in the same manner as obligations issued or guaranteed as to principal and interest by the United States or its agencies or instrumentalities. This provision specifically overrides the preemption of state law contained in section 106(c) of the Secondary Mortgage Market Enhancement Act of 1984, Public Law Number 98-440.

Subd.19. *State.* "State" means any state, territory or possession of the United States, the District of Columbia and Puerto Rico.
[Sec.80A.14 amended by Laws 1986, Ch. 358,Laws 1987, Ch.336.]

[¶33,115]

Sec.80A.15 Exemptions. Subdivision 1. The following securities are exempted from sections 80A.08 and 80A.16:

(a) Any security, including a revenue obligation, guaranteed by the United States, any state, any political subdivision of a state or any corporate or other instrumentality of one or more of the foregoing; but this exemption shall not include any industrial revenue bond. Pursuant to section 106(c) of the Secondary Mortgage Market Enhancement Act of 1984, Public Law Number 98-440, this exemption does not apply to security that is offered or sold pursuant to section 106(a)(1) or (2) of that act.

(b) Any security issued or guaranteed by Canada, any Canadian province, any political subdivision of any province, any agency or corporate or other instrumentality of one or more of the

STATE OF MINNESOTA

IN THE SUPREME COURT
CAUCUS DISTRIBUTORS, INC., ET AL
Petitioners

V.

COMMISSIONER OF COMMERCE
Respondent

PETITION FOR REVIEW
OF DECISION OF COURT
OF APPEALS
Appellate Court Case

DATE OF FILING OF COURT OF APPEALS
DECECISION: April 5, 1988

No. C4-87-1952

TO: The Supreme Court of the State of Minnesota

The Petitioners, Caucus Distributors, Inc., Campaigner Publications, Inc., and Independent Democrats for LaRouche request a Supreme Court review of the above entitled decision of the Court of Appeals upon the following grounds:

I. STATEMENT OF FACTS AND PROCEDURAL HISTORY

Petitioners are New York corporations. Independent Democrats for LaRouche is an unincorporated association organized and qualified under the Federal Election Campaign Act, 88 Stat. 1263. Martha Mitchell, a Minnesota citizen, approached by an individual passing out informational pamphlets took one and purchased a subscription to some publications supporting viewpoints also supported by Lyndon R. LaRouche. She had previously heard Mr. LaRouche on television and was in sympathy with his views.

Subsequently, Martha Mitchell made several loans to Petitioners, some of which were repaid, some of which were not. The only loan made to Independent Democrats for LaRouche in the amount of $1,000.00 was in conformity with the specific regulations of the Federal Election Commission. It was duly repaid. In return for the loans, Petitioners gave notes specifying the amount of the loan and interest rates. The notes ranged for various periods of time from three months to three years.

Minnesota issued a Cease & Desist Order on July, 1986 and a hearing was held August 4, 1986; on October 6, 1986 the administrative law judge issued a discovery order requiring Petitioners to provide a list of persons who made loans to Petitioners after September 1, 1983. Petitioners resisted on the grounds that the release of the names of their lenders would have a chilling effect on the exercise of the first amendment rights of those lenders. Almost half of the lenders requested their names not be disclosed to the Attorney General. The Administrative Law Judge ruled a prima facie chilling effect showing had been made. The administrative law judge then imposed sanctions precluding Petitioners from

contesting portions of the amended cease and desist order, effectively defaulting Petitioners.

On September 3, 1987, Michael A. Hatch, Commissioner of Commerce, found that Petitioners had offered and sold unregistered securities in the State of Minnesota and ordered Petitioners to cease and desist.

II. STATEMENT OF LEGAL ISSUES AND THEIR RESOLUTION BY THE COURT OF APPEALS

Petitioners appealed to the Minnesota Court of Appeals and the decision of the Court of Appeals was filed April 5, 1988.

The Minnesota Court of Appeals found that:

(1) Discovery sanctions did not impermissibly deprive Petitioners of a right to be heard;

(2) The factual findings of the Commissioner were supported by
substantial evidence;

(3) The promissory notes evidencing loans to Petitioners were securities under Minnesota Statute Section 80A.14;

(4) The Federal Election Campaign Act does not preempt regulation of securities in reference to Independent Democrats for LaRouche:

(5) Minnesota securities laws as applied in this matter did not impermissibly infringe on Petitioner's first amendment rights of association, and;

(6) Certain materials were stricken from Petitioner's brief.

Specifically, a copy of a loan repayment agreement of the Ronald Reagan Congressional Victory Fund and other portions of Petitioner's brief referring to fund raising activities of Republicans.

Sanctions imposed by the administrative law judge in this matter for Petitioner's resistance to the State's discovery orders, were improper and, in fact, resulted in Petitioners being unable to present their case. Those discovery requests were for Petitioner's contributor and lender list. Were Petitioner's contributors and lenders to believe their names would become a matter of public record and be circulated among state departments who happened to be politically opposed to them, this would have a chilling effect on those contributors and lenders willingness to support Petitioner's organizations. See Britt v. Superior Court of San Diego County, 574 P.2d 766 (1978) and FEC v. Hall Tyner Election Campaign Committee, 678 F.2d 416 (1982). The State had sufficient facts available through testimony of parties to the transaction and through their own investigation to determine whether or not the loan in question was a security. See also Savika v. Webster. 644 F.2d 743 (1981).

The second issue is that the Commissioner made certain factual findings that were not supported by the record. There was no evidence in the record to suggest that Mr. Bettag solicited loans. The testimony of Mrs. Mitchell was that she only spoke with Mr. Bettag about payments (Tr. 85) and these were already after she had made the loans. (Tr. 98) Mrs. Mitchell testified that the only one who asked her to make loans was Appellant Fredman. (Tr. 98-99) The Court of Appeals made a finding that Bettag sold loans based on the assumption that the evidence which was not produced in response to the discovery request would have shown this. This was patently false, as Mrs. Mitchell did testify that Bettag solicited no loans.

The third issue is the Gravamen of this case since if the notes in question were not securities, then the State's intrusion into the activities of Petitioners would have been improper. The notes in question are not securities and that the Minnesota Act itself coupled with applicable case law indicates that the term security only has the meaning given to it that the context involved requires. See Landreth Timber Company v. Ivan K. Landreth, 471 U.S. 681, 105 S.Ct 2297, 85 L.Ed.2d 692 (1985); Lino v. City Investing Company, 487 F.2d 689 (3rd Cir., 1973). The transaction in question in this case did not bear the characteristics of an investment. There was no "expectation of profit based upon the entrepreneurial/managerial skill of others." Great Western Bank X Trust v. Kotz, 532 F.2d 1252 (9th Cir., 1976). Further, these loans were made with only the expectation of a set rate of interest not contingent upon the managerial or entrepreneurial efforts of Petitioners. Therefore, the loans are not securities. Union Planters National Bank of Memphis v. Commercial Credit Business Loans, Inc., 651 F.2d 1174, 1185 (6th Cir., 1981). The Court of Appeals in this matter essentially found that these notes in question were securities because the Minnesota Act must be construed as broadly as possible in order to protect members of the public.

Petitioners contend that the application of the Minnesota Securities Law to the Independent Democrats for LaRouche organization raises a federal preemption issue since the Federal Election Campaign Act expressed Congress' intent to preempt this area. See Silkwood v. Kerr-McGee Corp., 104 S.Ct 615, 621 (1984). Specifically, Petitioners contend that Section 301 of the FEC Act Amendments of 1974 at 2 U.S.C. Section 453 provide:

> "The provision of this Act and the rules prescribed under this Act supersede and preempt any provision of state law with

respect to election of federal office."

Finally, Petitioners argue that because they are a political organization, the First Amendment protects them from a broad and forced disclosure of information in connection with their first amendment activities. The First Amendment would require that the definition of security be made much less broad due to the first amendment impact on the context of the transactions involved. There is and should be a distinction between a transaction for political purposes and one for commercial purposes. See in re Primus, 436 U.S. 412 (1978) and Ohralik v. Ohio State Bar Association, 436 U.S. 447 (1978).

For these reasons, the Petitioner seeks an order granting review of the decision of the Court of Appeals.

DATED:

Respectfully submitted,

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COM/S-86-047-JL

8-1005-698-2

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE MINNESOTA DEPARTMENT OF COMMERCE

In the Matter of Caucus Distributors, Inc., and Campaigner Publications, Inc., New York Corporations,Independent Democrats For LaRouche,an Unincorporated Association, RonFredman, Ronald R. Bettag, Paul Greenberg, and All Other Persons and Organizations Acting in Concert with the Named Respondents.

The above-entitled matter came in for hearing before Administrative Law Judge Jon L. Lunde commencing at 9:00 a.m. on Monday, August 4. 1986 at the Office of Administrative hearings in Minneapolis, Minnesota. Additional proceedings were held the following day. The hearings were held pursuant to a Cease and Desist Order, Notice of Right to Hearing and Order Suspending Exemption issued by the Commissioner of Commerce on June 4, 1986. and an Amended Cease and Desist Order. Notice of Right to Hearing and Order Suspending Exemption issued by the Deputy Commissioner of Commerce on July 17, 1986.

Jerome L. Getz, Special Assistant Attorney General, 1100

Bremer, Seventh Place and Minnesota Street. St. Paul, Minnesota 55101. appeared on behalf of the Minnesota Department of Commerce (Department). Patrick J. Moran, Moran & Pilger, P.A.. Attorneys at Law. 1221 Lamar, Suite 517, Houston, Texas 77010, appeared on behalf of each of the above-captioned organizations and individuals. The record closed on May 20. 1987, when the last authorized brief was filed.

This Report is a recommendation, not a final decision. The Commissioner of the Minnesota Department of Commerce will make the final decision after a review of the record which may adopt, reject or modify the Findings of Fact, Conclusions, and Recommendations contained herein. Pursuant to Minn. Stat. § 14.61, the final decision of the Commissioner shall not be made until this Report has been made available to the parties to the proceeding for at least ten days. An opportunity must be afforded to each party adversely affected by this Report to file exceptions and present argument to the Commissioner. Parties should contact Michael A. Hatch, Commissioner of Commerce. State of Minnesota, Fifth Floor Metro Square Building, St. Paul. Minnesota 55101 to ascertain the procedure for filing exceptions or presenting argument.

STATEMENT OF ISSUES

The issues in this proceeding, as set forth in the Amended Cease and Desist Order of July 17. 1986, are as follows:

> Whether the Respondents offered and sold unregistered securities consisting of promissory notes to Minnesota residents and did so without the requisite licenses.

Whether all or any one of the Respondents fraudulently misdated a promissory note issued 10 a Minnesota resident and fraudulently or deceitfully advised the prospective purchaser of promissory notes issued by the Respondents that some banks were failing, contrary to the provisions of Minn. Stat. § 80A.Ol(c).

Whether the Respondents or any of them failed to state material facts necessary to make statements made during the offer and sale of promissory notes not misleading in violation of Minn. Stat. § 80A.Ol. clauses (b) and (c).

Based upon all of the proceedings herein, the Administrative Law Judge makes the following:

FINDINGS OF FACT

1. Caucus Distributors, Inc. (Caucus' is a Not-For-Profit corporation incorporated under the laws of the State of New York. The Certificate of Incorporation its incorporators filed with the New York Department of State on April 5, 1982 reads in part as follows:

2. The corporation * * * is not formed for pecuniary profit or financial gain, [and] * * * no part of the assets, income or profit of the corporation is distributable to, or inures to the benefit of its members, directors or officers or any private person except to the extent permissible under the Not-For-Profit Corporation Law.

3. The purposes for which the corporation is formed are:

> To promote and encourage the political.and [sic] ideas and beliefs fostered by the International Caucus of Labor Committees and other organizations advocating the same ideas and beliefs; to distribute to the general public, sell and obtain subscriptions to publications specifically dedicated to the political ideas and beliefs fostered by the International Caucus of Labor Committees and other organizations to sclicit membership for certain membership organizations associated with the publications distributed by the corporation consonant with the goals, purposes and programs of those organizations;
>
> to advertise and promote the publications distributed by the corporation;
>
> to engage the services of writers, reporters, editors, distributors. corporations, associations, partnerships and news agencies in furtherance of these purposes;
>
> * * *

2. Campaigner Publications, Inc. (Campaigner) is a New York corporation.

3. Independent Democrats for LaRoiche (IDL) is an unincorporated association and a political committee apparently recognized by the Federal Election Commission. Paul Greenberg is an authorized representative of IDL and is empowered to sign notes on its behalf.

4. At all times material to this case. Ron Fredman and Ronald R. Bettag worked for Caucus and solicited loans to Caucus, IDL and Campaigner by selling notes for them.

5. Ron Fredman. Ronald R. Bettag and Paul Greenberg are not and have never been licensed by the Department to sell securities in the State of Minnesota. Likewise, Caucus, Campaigner and IDL are not and never have been licensed by the Department to sell securities in the State of Minnesota.

6. Mary M. Mitchell, an 85-year-old widow. is a resident of Minneapolis. Minnesota. She has lived there since moving from Winona in 1938. Mitchell is a retired stenographer who has a high school education.

7. In July, 1984, while walking on the Mall near Seventh and Nicollet in downtown Minneapolis. Mitchell was given a pamphlet pertaining to the presidential candidacy of Lyndon LaRouche. She told the man who gave her the pamphlet that she had seen LaRouche on television and liked what she saw. The man told her that if she gave him her name and telephone number someone would call her with more information about LaRouche. She gave him that information.

8. Approximately one week after her encounter on the Mall. Ron Fredman telephoned Mitchell from Chicago to talk to her about LaRouche, Caucus. Campaigner and IDL. Fredman told Mitchell about corruption in the world and the need for Americans to clean it up. He specifically mentioned drug trafficking in the Middle East and South America. the laundering of Mafia money by banks, the decline in American culture, and bank failures. He told Mitchell that some banks were shaky and that if the United States didn't pull together, everyone would go bankrupt. Fredman told Mitchell that LaRouche needed her help with these problems and he asked her for a contribution. She agreed to make a $25 contribution

at that time, and he made arrangements for her to receive copies of "New Solidarity" and other publications.

9. During that initial telephone conversation, Fredman also asked Mitchell to help by making loans. Fredman told her that she would receive a promissory note for any loans she made and that she could specify the interest rate and the term of the notes. Since she would get a promissory note and could specify the interest rate, Mitchell concluded that the loans would be similar to a banking transaction. Moreover, since LaRouche was "in the limelight", she concluded that she was not dealing with a fly-by-night operation that would skip the country, and that her loans would be a good investment. Therefore, she agreed to make a $15,000 loan at that time. In return, she was to receive two notes payable at the end of three years. One was to be made payable to her and her stepson, R. Keith Mitchell, in the principal amount of $10,000. The other was to be.made payable to her and her sister-in-law, Mozell Hall, in the principal amount of $5,000. Fredman personally collected two checks in the aggregate amount of $15,000 from Mitchell at her home in Minneapolis early in July 1984. Later that month. two promissory notes were mailed to her in the aggregate principal sum of $15.000. The notes stated the payees, amounts, term and interest rate Fredman promised.

10. On September 3, 1984, Fredman called Mitchell again and asked her to loan $1.000 to IDL. She agreed to make a $1,000 loan to IDL for one year at ten percent interest. Following her conversation with Fredman. she mailed him a $1.000 check payable to IDL's order. A few days later, she received a promissory note signed by Paul Greenberg, as an authorized representative of IDL. The note was in the principal sum of $1,000. bore interest at the rate cf ten percent, and was payable in one year. The note, and accumulated interest thereon, was paid by IDL in July 1986.

11. On or about September 17, 1984, Fredman telephoned Mitchell again to give her an update on the activities of the LaRouche organizations. At that time, he gave her more information on their efforts to eliminate drug traffic and related activities in the Middle East. In addition, he talked about a publication entitled "Dope. Incorporated" which one of the organizational Respondents had published. During that telephone conversation, Mitchell agreed to make an additional $5.000 loan to Caucus for 90 days with interest at 15 percent. Immediately after her telephone conversation with Fredman, Mitchell mailed him a check payable to Caucus in that amount. A few days later, Mitchell received Caucus' promissory note incorporating the loan terms she and Fredman had discussed.

12. On or about November 26, 1984. Fredman called Mitchell to solicit another loan. During that conversation, Mitchell expressed regret for having made the initial $15,000 loan for a term of three years. He told her that if she returned the notes to him, he would issue two new notes which would mature in a year (on November 26, 1985). At that time, Fredman persuaded Mitchell to make an additional $10,000 loan to Caucus for six months. When Mitchell told Fredman she was getting 14 percent on a certificate of deposit with her bank, he said that Caucus would pay 16 percent on the loan.

13. On or about November 26, 1984, a $10,000 promissory note signed by Fredman for Caucus was mailed 10 Mitchell. It reflected a six-month term and a 16 percent interest rate as she and Fredman had agreed on November 26. At the same time, Mitchell was mailed two promissory notes replacing those which she had returned due to her dissatisfaction with their three-year maturity date. Exhibits 19 and 23. Those notes were signed by Fredman for Campaigner

and reflected a one-year term and a 12 percent interest rate. The payees were the same as those in the notes originally issued.

14. Caucus' September 17, 1984 note for $5,000 was due on December 17, 1984. On or about the due date, Fredman called Mitchell and told her that the note could not be paid because their assets had been frozen by a bank, and he asked her if she would accept a one-third partial payment. Although Mitchell agreed that the bank's explanation for freezing Caucus' funds was "outlandish", she said she would like half of the note paid. Fredman said he would see if that could be done and call her back. Early in January, 1985, after Mitchell returned from a vacation, Fredman called her and asked if she would accept a new note covering Caucus' $5,000 loan to be payable in five monthly principal installments of $1,000 commencing May 1, 1985 and a lump sum interest payment on October 1, 19B5. She agreed and a short time later received a new promissory note from Caucus in the principal sum of $5,000.

Exhibit 17. That note contained the payment terms she had agreed to accept and was signed by Fredman for Caucus.

15. In April 1985, Mitchell asked Fredman if the beneficiaries on Campaigner's November 26, 1984 notes could be changed. He said that could be done and they agreed that Campaigner's two notes (Exhibits 19 and 23) would be destroyed and that one new note would be issued in the principal amount of $15,000. Mitchell also agreed that the rate of interest could be reduced from 12 percent to 10 percent in the new note. Exhibit A. A short time later, a $15,000 note payable in one year with interest at 10 percent was mailed to her. Exhibit 24. Caucus was listed as the payor of that note

and it was signed by Fredman. The note was dated April 16, 1985 rather than November 26, 1984. Mitchell did not receive interest in the $15,000 loan between November 26, 1984 and April 16, 1985. did not agree to waive interest earned during that time, and did not authorize a change in the date of the two notes when they were rolled over and consolidated.

16. During the telephone conversation between Mitchell and Fredman on April 10, 1985, Mitchell agreed to make an additional loan to Caucus in the amount of $10,000. The loan was made in two separate payments to Caucus. A $6,000 payment was made by a check dated April 10, 1985 and a $4,000 payment was made to Caucus by a check dated April 26, 1985. On or about April 29. 1985. Caucus' $10,000 promissory note was mailed to Mitchell. The note. which was signed by Fredman, carried an interest rate of 10 percent and was payable in six months.

17. Apart from her loan to IDL, Mitchell loaned $40,000 to Caucus between July 1984 and April 29. 1985. As of November 21, 1985, only $2.000 had been repaid to her. A $1,000 payment was made late in April 1985, a $500 payment was made on November 6, 1985 and a $500 payment was made on September 30, 1985 (two checks).

18. During their telephone conversations in 19B4 and 1985, Mitchell and Fredman primarily talked about Caucus, but he never explained his relationship to Caucus, Campaigner or IDL. In addition, he never told her how they would repay the loans, if they had solicited loans from other persons, or if they had repaid those loans in a timely fashion.

19. All of Mitchell's loans to the Respondents. except the

$1,000 loan made to IDL, were made by check payable to Caucus. All the checks were presented for payment and paid by her bank. All the loans were solicited by Fredman. Mitchell had no direct contact with Greenberg and had very limited contact with Bettag. Her only contact with Bettag occurred in 1985 after she became concerned about the repayment of her notes. Bettag told her that the LaRouche organizations stand behind their commitments and that notes were good investments. Bettag explained that money wasn't coming in as fast as they had expected, but that all her loans would be repaid and that her money was safe.

20. After her conversation with Bettag, Mitchell advised family members about the loans she had made to the Respondents and the delinquencies that existed. Later, with their advice and input, she retained counsel and the Department was eventually informed of the transactions.

21. In late November of 1985, Joyce Rubenstein. a Caucus representative, telephoned Mitchell from New York to discuss her loans to Caucus. Rubenstein advised Mitchell that if she would make an additional $10,000 loan to Caucus she would be sure to get the rest if her money ($40,000) back. Based on these representations, Mitchell loaned Caucus another $10,000 for eight months at 12 percent. On November 29, 1985, Mitchell received confirmation from Caucus that the loan had been made under these terms. Confirmation was in a letter form. No note was issued as had been done in the past.

22. Mitchell considered all of her loans to the Respondents as investments, not unlike certificates of deposit that individuals can purchase from a bank. None of her loans were intended to be contributions and none of them were

collateralized. Apart from IDL's note. most of the notes issued were notarized by Bettag and most specifically stated that they could not be assigned. transferred or discounted. All of them were signed by Fredman.

23. In 1984 and 1985, the Respondents solicited loans from other Minnesota residents and from residents in other states including Illinois, Maryland, Alaska. Indiana and Washington.

24. No individual employed by or representing the Respondents gave Mitchell any financial information regarding the organizational Respondents that she could use to determine their ability to repay the loans she made. She was not told how the Respondents would be able to repay her loans. where the money used to repay her loans would come from. or what the risks of her investments were. Mitchell was not advised if Caucus was in default in its obligation to repay principal and interest to other investors or that one judgment had been entered against Caucus for failure to repay a loan when due. Moreover, Mitchell was never advised that the Respondents were not licensed to sell securities in the State of Minnesota or that the notes were not registered as required by law. In fact, Fredman told Mitchell that the loans were legal.

Based on the foregoing Findings of Fact. the Administrative Law Judge makes the following:

CONCLUSIONS

1. That the Minnesota Commissioner of Commerce and the Administrative Law Judge have authority to consider the

issues raised by the Commissioner's Cease and Desist Order and Order Suspending Exemption, as amended. under Minn. Stat. §§ BOA.21, 80A.15. subd. 3, and 14.50 (1984).

2. That the Department has complied with all relevant substantive and procedural requirements of law and rule and that the Respondents received proper and timely notices Xf the hearing and of the Commissioner's Orders.

3. That under Minn. Rule 1400.7300, subp. 5, the Department has the burden of proof to establish the statutory violations alleged by a preponderance of the evidence.

4. That the loans solicited by Ron Fredman and the notes issued by the organizational Respondents constituted offers and sales for purposes of Minn. Stat. § 80A.14, subd. 17 (1984X.

5. That the promissory notes offered and sold by the Respondents in the State of Minnesota constitute securities for purposes of Minn. Stat. § 80A.14. subd. 18 (1984)..

6. That the promissory notes offered and sold by the Respondents in the State of Minnesota were not registered with the Commissioner prior to or at the time of their offer of sale as required by Minn. Stat. § 80A.08 (1984).

7. That the Respondent Ron Fredman violated Minn. Stat. § 80A.014, subd. 1, by transacting business in this State as an agent without a license to do so.

8. That the organizational Respondents violated Minn. Stat. § BOA.04. subd. 2, by employing Ron Fredman as their agent.

9. That in connection with the sale of promissory notes to Mary Mitchell, the Respondents Ron Fredman and Ronald R. Bettag failed to state material facts necessary in order to make statements that were made not misleading, contrary to M1nn. Stat. § 80A.04, clause (b) (1984), by failing to disclose financial information which could have been used to determine the organizational Respondents' ability to repay the note$ when due and by failing to advise Mitchell that none of the Respondents were licensed to sell securities in the State of Minnesota and that the promissory notes were not registered pursuant to the Minnesota Securities Act.

10. That the Cease and Desist order proposed by the Commissioner is in the public interest and should be issued.

11. That under Minn. Stat. § 80A.15, subd. 4, the Respondents have the burden Xf proving any exemption claimed under Minn. Stat. § 80A.Ol to 80A.31 or any exception from a definition contained therein.

12. That the Respondents have failed to establish that the promissory notes they sold are subject to any exemption or exception.

13. That the Respondent Ron Fredman fraudulently misdated one of the promissory notes issued to Mitchell in violation of Minn. Stat. § 80A.Ol. clause (c) (1984).

14. That the Respondent Ron Fredman did not violate Minn. Stat. § BOA.Ol, clause (c) by telling Mitchell that some banks were falling.

Based on the foregoing Conclusions of Law, the Administrative Law Judge makes the following:

RECOMMENDATION

That the Cease and Desist Order and Order Suspending Exemption be made permanent.

Dated this 15th day of July, 1987,

JON L. LUNDE
Administrative Law Judge

Reported: Transcript Prepared.

MEMORANDUM

BURDEN OF PROOF

The Department argues that its only burden of proof on the question whether the Mitchell notes are securities is to show that the Respondents solicited loans from her and issued promissory notes reflecting the loans. It argues that the Respondents then have the burden to establish that the notes are not securities, citing Minn. Stat. § 80A.15. subd. 4 and Exchange National Bank v. Touche, Ross & Co., 544 F.2d

1126 (2d Cir. 1976). Under the cited statute. the burden of proving an exemption or an exception from a definition is upon the person claiming it. Hence. to the extent that the Respondents claim any statutory exemption or exception from a definition, they have the burden of proof. However, the Judge is not persuaded that the enforcement division's burden can be met merely by showing that the Respondents made a loan in this State and issued a note evidencing that loan. In Landreth Timber v. Landreth. 471 U.S. 681. 105 S. Ct. 2297, 85 L. Ed. 2d 692 (1985), the United States Supreme Court refused to hold that one could prove a security (note) simply by proving the document itself, which is exactly the result the enforcement division argues is appropriate. Moreover, under Minn. Rule 1400.7300. subp. 5. the Judge is persuaded that the Department has the burden of establishing that the notes were offered and sold as investments rather than commercial loans.

The definitions in the Minnesota Securities Act, like those in most securities acts[1] , apply "unless the context otherwise requires" Minn. Stat. § 80A.14, subd. 1. The courts have frequently cited this language to support departures from the literal definition of a security when required by the context in which the instrument alleged to be a security is offered or sold. See. e.g., Marine Bank v. Weaver, 455 U.S. 551, 556, 102 S. Ct. 1220, 71 L. Ed. 2d 409 (1982); Lino v. City Investing Co., 487 F.2d 689! 694 (3d Cir. 1973); State v. Hoephner, 574 P.2d 1079, 1081 (Okl. Cr. 1978). Although the courts have cited the "unless the context otherwise requires" language to avoid applying the securities definition literally, they generally have not held that the language was intended to change the normal burden of proof in civil or administrative proceedings and they have not held that that language

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[1] See 15 U.S.C. §78c(a)(10) and 77b(1) and the Uniform Securities Act of 1985, § (ULA 1987 Supp.).

constitutes an "exemption" or an "exception" that the Respondent has the burden to establish.

In Exchange National Bank, the court held that the statutory definition of a security should be applied literally and that persons seeking to avoid the plain language of the statute have the burden to establish that the context requires a different result. The literal test adopted in Exchange National Bank has been implicitly rejected by the United States Supreme Court. See United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 849, 95 S. Ct. 2051. 2059, 44 L. Ed. 2d 621 (1975) and Landreth Timber Co. v. Landreth, supra, 105 S. Ct. at 2306 (1985). Moreover, it has apparently been rejected by every'See 15 U.S.C. § 78c(a)(lO) and 77 b(l) and the Uniform Securities Act of 1985. § 101 (ULA 1987 Supp.).other federal circuit court of appeals that has considered the issue. See. e.g., Hunssinger v. Rockford Business Credits Inc., 745 F.2d 484 (7th Cir. 1984); McClure v. First National Bank of Lubbock, 497 F.2d 490 (5th Cir. 1974), cert. den. 420 U.S. 930 (1975); Lino v. City Investing Co., supra. In addition, it has not been adopted in Minnesota. The Minnesota Supreme Court has always examined the economic reality of the instrument or transaction. See, e.g.. State v. Investors Security Corporation, 209 N.W.2d 405 (Minn. 1973). Recently it reaffirmed its preference for examining the context (economic reality). Rice County Specialized Tours, Inc. v.Hagen. 292 N.W.2d 520, 535 (Minn. 1986).

For all these reasons, it is concluded that the Department has the burden of establishing that the notes issued by the Respondents involved an investment rather than an ordinary commercial transaction and if such X showing is made. the note will constitute a security unless the Respondents can point to a specific statutory exemption or exception that applies to them.

The fact that the Respondents were precluded. by order, from presenting evidence showing that its notes are not securities is not equivalent to a default on that issue as the enforcement division has argued. When there is noncompliance with a discovery order, the Judge may order that certain facts be taken as established for purposes Xf the case, refuse to allow a party to support or oppose designated claims or defenses. or prohibit a party from introducing designated matters in evidence. Minn. Rule 1400.6700. subp. 3. In this case, the Respondents were precluded from opposing certain claims made by the Department. However, the Department was not granted a default judgment on those issues and it still has a burden of proof to meet. Consequently, the

Respondents' notes cannot be deemed to be securities under the theory that the Respondents are in default.

ARE THE PROMISSORY NOTES SECURITIES?

The first and most basic substantive issue that must be resolved in this case is whether the promissory notes Fredman sold to Mitchell for the organizational Respondents constitute securities. Minn. Stat. § 80A.14, subd. 18(a) defines a security as follows:

> "Security" means any note: stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit sharing agreement

In spite of the inclusive scope of the definition of a

security, the words used, including the words "any note"X cannot be literally applied. United Housing Foundation, Inc. v. Forman, supra. Instead. substance must prevail over form and the context in which an instrument is offered or sold must be examined to determine the economic reality involved. Tcherepnin v. Knight, 389 U.S. 332, 336, 88 S. Ct. 548, 553, 19 L. Ed. 2d 564 (1967). When the economic reality is that an investment rather than a commercial transaction is involved, the instrument will be treated as a security: otherwise, it won't. See, e.g.. Baurer v. Planning Group, Inc.. 669 F.2d 770. 775 (D.C. Cir. 1981). The Minnesota Supreme Court has not addressed the scope of the words "any note" and it has not adopted a test for determining when a note is a security. Consequently, the decisions of federal courts and other state courts and agencies must be consulted. This follows from the provisions of Minn. Stat. § 80A.31, which states:

Sections 80A.Ol to 80A.31 shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation of sections 80A.Ol to 80A.31 with the related federal regulation.

See Specialized Tours, Inc. v. Hagen, supra at 535; Hayden v. McDonald, 742 F.2d 423. 428 (8th Cir. 1984).

Generally speaking, four tests have been adopted for determining when an instrument is a security: (1) the literal test. (2) the commercial/investment dichotomy test, (3) the risk capital test, and (4) the Howey test. However. there are variations to these tests and some basic principles that are always considered by the courts in determining what instruments are securities.

Although at least four different tests for determining when an instrument is a security have been adopted by the courts, the Judge is persuaded that the only appropriate test that should be used in determining whether a note is a security is the commercial/investment dichotomy test. The literal test articulated in Exchange National Bank of Chicago v. Touche Ross & Co., supra, has been implicitly rejected by the United States Supreme Court. In United Housing Foundation, Inc. v. Forman, 421 U.S. at 849, the court reiterated the need to examine the economic realities underlying a transaction and not the name attached to it, noted (footnote 14) that all but one of the Federal circuits that had recently considered the scope of the definition of a security had rejected a literal approach, and went on to examine the economic realities underlying the purchase of shares in a cooperative housing project to determine if they were securities. Subsequently, in Landreth Timber Co. v. Landreth, supra, the court did adopt a literal approach where stock is involved. but refused to do so for notes. The court stated. (105 S. Ct. 2306):

> . . . "note" may now be viewed as a relatively broad term that encompasses instruments with widely varying
> characteristics, depending on whether issued in a consumer context, as commercial paper, or in some other investment context. * * * We here expressly leave until another day the question whether "notes" or "bonds" or some other category of instrument listed in the definition might be shown "by proving [only] the document itself." * * * We hold only that "stock" may be viewed as being in a category by itself for purposes of interpreting the scope of the Acts' definition of "security."

In Landreth, the Supreme Court.said that instruments that bear both the name and all the usual characteristics. of stock present the clearest case for coverage by the plain language of the definition and should be treated as securities. Accordingly,

the court proceeded to apply the federal acts to the sale of 100 percent of the stock of a business. Although the United States Supreme Court has moved closer to the literal test generally applied by the Second Circuit. it strongly implied that the literal test is inappropriate in many situations and will be limited to stocks. In Specialized Tours, Inc. v. Hagen. supra. the Minnesota Supreme Court followed the Landreth decision but expressed dissatisfaction with it, noting that if it were writing on a "clean slate", it would have reached a different result by examining the economic realities xf the transaction. Since the Second Circuit's literal approach has not been accepted by the United States Supreme Court except in a modified version when stock is involved, and since the Minnesota Supreme Court has expressed dissatisfaction with it, it is concluded that the Commissioner should not apply that test in this case, even though it is discussed further below.

Also, the Judge is persuaded that application of the Howey test is inappropriate. The Howey test was adopted by the United States Supreme Court in SEC v. W.J. Howey Co., 328 U.S. 293 (1946) to identify "investment contracts" for purposes of the securities laws. The court described an investment contract as a transaction, contract or scheme whereby a person invests money or value in a common enterprise and is led to expect profits derived solely from the efforts xf the promoter or some third party. The First Circuit applied the Howey test to notes sold by a religious organization. SEC v. World Radio Mission,. Inc., 544 F.2d 535, 538 (1st Cir. 1976). However, it did not rely exclusively on Howey or explain why the Howey test was used. More important, other federal courts have rejected its use for any securities but investment contracts. In Landreth. the United States Supreme Court reaffirmed the fact that the Howey test was designed only to determine whether an investment contract constitutes a security. stating (105 S. Ct. at 2305):

> we would note that the Howey economic reality test was designed to determine whether a particular instrument is an "investment contract," not whether it fits within any of the examples listed in the statutory definition of "security" Our cases are consistent with this view. . Moreover, applying the Howey test to traditional stock and all other types of instruments listed in the statutory definition would make the Acts' enumeration of many types of instruments superfluous.

The Howey test has also been specifically rejected by several federal courts of appeals as an analytical tool for determining whether a note is a security. Hunssinger v. Rockford Business Credits, Inc., 745 F.2d 484. 492 (7th Cir. 1984); Exchange National Bank v. Touche Ross & Co.. supra: and Daily v. Morgan, 701 F.2d 496 (5th Cir. 19B3). Based in these cases, the Judge is persuaded that the Howey test is inappropriate for determining whether a note is a security and that test will not be discussed further.[2]

The risk capital test that has been adopted by the Ninth Circuit Court of Appeals is discussed below. even though the Judge is not persuaded that it should be used by the Commissioner in this case. It was rejected in Exchange National Bank, supra, and the Judge believes that the reasons

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[2] Even if the Howey test is used. the notes sold by Respondents would be ,/ securities under World Radio Mission. See also State v. Weisser, 161 N.W.2d 360 (N.D. 1968).

stated in that decision for rejecting the risk capital test are persuasive.

LITERAL TEST

Apart from the literal test for stocks adopted in Landreth. the literal test adopted in Exchange National Bank of Chicago v. Touche Ross & Co., supra, is the most inclusive test for determining whether a particular instrument is a security. In that case, the court held that the plain language of the federal statute should be closely followed and that notes should be treated as securities unless the context of the transaction clearly requires a different result. In discussing the kinds of notes that would not be included. the court referred to:

> the note delivered in consumer financing. the note secured by a mortgage on a home, the short-term note secured by a lien on a small business of some cf its assets. the note evidencing a "character" loan to a bank customer. short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the.case of the customer of a broker, it is collateralized)

Id. at 1138.

The inclusive. literal approach adopted in Exchange National Bank places a substantial burden on the issuer of notes to establish that the notes are required to be excluded from the definition. The burden placed on the issuer would apparently demand a clear showing that characterizing the

notes as securities would disrupt the settled expectations of both parties. interfere with routine transactions, provide additional protection where no such protection is needed,.or produce some other clearly undesirable result. See Petitioner's Post-Hearing Brief, Appendix 2, p. 19).

In this case. the notes Mitchell purchased do not bear any resemblance to the kinds of notes mentioned in Exchange National Bank as outside the scope of the securities laws. They are not the kind of routine loan transactions to which the securities laws should not apply and there is no evidence that the parties had any settled expectations regarding the status of the notes under the securities laws. In fact, Mitchell clearly regarded her loans as an investment similar to the purchase of certificates of deposit from a bank. Moreover, the loans Mitchell made appear to be the kind of transactions the securities laws were designed to cover and are the kind of investments that need the protections of the securities laws of this State. After all. Mitchell was unsophisticated in financial matters and incurred a significant risk without the ability to obtain and evaluate the information needed to make an informed investment decision. For these reasons, it is concluded that the notes sold to Mitchell constitute securities under the literal test.

RISK CAPITAL TEST

The "risk capital test" was devised by the California Supreme Court in Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 13 Cal. Rptr. 186, 361 P.2d 906 (1961). It is not an appropriate test for determining the status of an instrument as a security in all cases. United Housing Foundation, Inc. v. Format, supra. 421 U.S. 837 at 857 n. 24. However, in Great Western Bank & Trust v. Kotz. 532 F.2d 1252 (9th Cir. 1976). the Ninth Circuit used the risk

capital test to determine whether the notes involved in that case were securities. Generally speaking. the ultimate inquiry under the risk capital test is whether the lender contributes "risk capital" that is subject to the entrepreneurial or managerial efforts of the borrower. In determining if it is, the duration of the loan, the amount of collateralization, the circumstances of issuance, the relationship between the amount borrowed and the size of the borrower's business, and the contemplated use of the proceeds must all be considered. Because the loans Mitchell made were not collateralized. because her loans and the loans other persons made to the Respondents were not discrete transactions--but part of a general offering made in a number cf states--and because the notes were not short-term-demand-notes. it is concluded that the notes are securities under the Kotz test. Clearly, Mitchell placed her capital at risk and was totally dependent upon the Respondents' efforts for payment.

Commercial/Investment Dichotomy Test

At least four federal circuits have adopted the commercial/investment dichotomy test for determining what notes constitute securities. See CNS Enterprises, Inc. v. G x G Enterprises. 508 F.2d 1354 (7th Cir. 1975): Baurer v. Planning Group, Inc. supra Lino v. City Investing Co., supra: and Bellah v. First National Bank, 495 F.2d 1109 (5th Cir. 1974). Under this test, the protection of the securities laws is confined to investors and not to borrowers and lenders in commercial settings. Thus, in determining whether a particular note is an investment, the courts examine the economic reality of the note to determine whether it was offered or sold as an investment. In this case, the Judge is persuaded that the notes sold by the Respondent to Mitchell constitute securities. In determining that the Respondents' notes were purchased as an investment and not as an incident to a commercial loan, the following factors.were considered:

a. whether the lender is a bank, financial institution or commercial lender in the business of making loans or a private party;

b. whether the notes were issued in connection with a consumer installment transaction or the purchase or real estate;

c. whether the notes were collateralized;

d. whether the sales took place outside the normal markets for notes and commercial paper;

e. whether the sales to Mitchell were an isolated set of transactions or part of a broader solicitation of loans from members of the public;

f. whether the proceeds of the loan were used to provide capital needed to finance a business or to purchase consumer goods and services.

g. the fact that notes are within the plain language of the definition of a security.

Consideration of these factors persuades the Administrative

Law Judge that the notes Mitchell purchased from the Respondents were bought as an investment. She considered her loans to be investments not dissimilar from the purchase of certificates of deposit from a bank. Moreover, Mitchell is not a typical commercial lender. Unlike a bank or other financial institution, she is not in the business of making loans, and the loans she made were not made in connection with a consumer installment transaction and they were not secured with any collateral. Likewise, they took place outside the normal markets for notes and commercial paper, and they were not an isolated transaction, but part of a broader solicitation of loans from members of the public. Although the loans paid a fixed rate of interest. the rate paid was higher, in some cases. than the rate Mitchell was receiving from her bank. Given the purposes of the securities law to protect members cf the public from fraud and imposition, and due to the lack of any commercial aspect to the notes. it is concluded that the notes sold by the Respondents were not of a commercial nature and that they constitute securities under the commercial/investment dichotomy test.

Treating the notes the Respondents sold to Mitchell as securities is consistent with the purposes of the Minnesota Securities Act, which is to regulate the merits xf securities in order to protect the public against fraud and imposition. State v. Investors Security Corporation. 209 N.W.2d 405, 408 (Minn. 1973). The Minnesota courts have consistently held that the securities laws should not be given a narrow construction. Sex, e.g.. Donovan v. Dixon, 113 N.W.2d 432. 443 (Minn. 1962). The Minnesota Supreme Court's expansive view of the securities laws has led to a consistent broadening of their coverage. State v. Investors Security Corporation. supra at 409. Treating the notes Respondents sold to Mitchell and other residents is consistent with the remedial purposes of the act and is necessary in order to

protect citizens of this State from fraud and imposition.

In determining when an instrument is a security, it is appropriate to consider the character given to the instrument in commerce by the terms of the offer, the plan of distribution and the economic inducements made by the offeror. Marine Bank v. Weaver, 445 U.S. 551. 556. 102 S. Ct. 1220 (1982). In this case, the Respondents represented its notes as investments, planned to sell notes throughout the State of Minnesota and other states in order to accumulate capital for a variety of unknown purposes. and held out economic inducements to Mitchell to purchase those notes. Those inducements included flexible maturity dates and competitive interest rates. There is no reason why the Respondents' notes should not be treated as they were represented to be. The solicitation of members of the general public seeking a passive return from their capital and the sale to them of units of a larger offering are the hallmarks of an investment transaction. Hunssinger v. Rockford Business Credits, Inc., supra at 492. In the enforcement of the securities act, it is not inappropriate that promoters' offerings be judged as being what they are represented to be. SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344. 352-53, 64 S. Ct. 120, 124, 8B L. Ed. BB (1943). In this case, the Respondents represented their notes as investments and they should be treated as such for purposes of the Minnesota Securities Act.

The mere fact that Respondents' instruments are called promissory notes is some evidence that they were intended to be covered by the securities act. While the name given to an instrument is not dispositive. it is not wholly irrelevant to a decision as to whether it is a security. As noted in United Housing Foundation, Inc. v. Forman, supra, 421 U.S. at B50-51. there may be occasions when the use of a name that appears in the definition of a security will lead a purchaser to

justifiably assume that the securities acts will apply. Although there is no evidence that Mitchell had any specific understanding that the securities acts would apply because the instruments were called notes, it is still appropriate to treat the notes as securities given the fact that they are called notes and contain the hallmarks of an investment transaction. Cf. Landreth Timber . v. Landreth, supra, 105 S. Ct. at 2306.

The Respondents argue that the notes they sold bear a fixed rate of interest and that the repayment of principal plus a fixed rate of interest does not constitute an expectation of profits under the Howey test. As mentioned before, it is not appropriate to apply the Howey test to notes purchased from an issuer by an investor. The Howey test may be appropriately applied when the investor takes a commercial note and packages it in some other form of investment contract. See. e.g., State v. Investors Security Corporation. supra. Marine Bank v. Weaver, supra. However, that was not done in this case. Notes and bonds are included in the definition of a security and ordinarily the return on an investment in those notes and bonds is in the form of interest. Consequently, as noted in Hunssinger. the mere fact that the Respondents' notes bore a fixed rate of interest is immaterial.

The Respondent also argues that the notes the Respondent sold are not securities due to the nature of the Respondent organizations. stating (Post-Hearing Brief. p. 18).

> These are not the usual investment transactions conducted by organizations and individuals interested only in making a profit on their business. Both the lenders and the recipients of the funds in these transactions were motivated by.certain firm social and political

> beliefs. These beliefs were the reason the loans were made to the Respondents, rather than an expectation of profit. Simply, the loans were made to support the Respondent organizations in their social, political and economic activities, not in a profitable business enterprise.

This argument is not supported by facts in the record. Although Mitchell said she would not loan money to the Respondents if she disagreed with their political and social goals, she was not willing to make substantial contributions (more than $25.00) to them in support of those goals and objectives. She invested money in their notes only because she considered them to be good investments that would be repaid with interest. Furthermore, when the issuer xf securities is not engaged in commercial activity, there may be a greater need for regulation because there will be no "profits" that can be used to repay a note. Rather, repayment will depend on the contributions or loans of third parties. The risks of such an enterprise are substantial.

Treating the organizational Respondents' notes as securities is consistent with the decision in Securities and Exchange Commission v. World Radio Mission, Inc.. 544 F.2d 535 (1st Cir. 1976) and the decisions of the Securities Commissions in California, Alaska, and Maryland. In World Radio Mission, the First Circuit Court of Appeals found that notes sold by a religious organization to members of the public were securities. The defendant in that case was a religious organization engaged in worldwide evangelical activities. It proselytized its beliefs through a radio program and by the publication and distribution of pamphlets, magazines and books. In order to establish a religious community in New England and to finance its other activities. the religious

organization raised funds through two types of investment plans. The investment plans involved the sale of interest-bearing notes. originally, the notes were issued in amounts of not less than $1,000 demoninations and were payable in seven years with interest at eight percent and with a 90-day notice acceleration clause. Later, there were variations in the notes that were sold with increased minimum amounts and interest as high as 12 percent. Sometimes there was no early withdrawal-of-principal feature. A second loan plan involved five-year $10,000 notes paying 9% interest with a bonus of an acre of land at the organization's New England community. The court found that the notes sold by World Radio Mission fell squarely within the literal language of the securities acts and the interpretive tests developed by the Supreme Court and specifically found that the religious motives of the investors were irrelevant because the notes were sold as investments to believers and nonbelievers alike. Id. at 539. In finding a security, the court cited the Joiner test that instruments should be judged by the character the instrument is given in commerce and by what they are represented to be, and concluded that they were represented to be investments. The same is true here. An investment involves the "placing of capital or laying out of money in a way intended to secure income or profit from its employment." Howey, 328 U.S. at 298. The notes sold to Mitchell were represented as good investments, she considered them to be good investments. and they should be treated as investments under the securities laws. Doing so is consistent with relevant court decisions, the decisions reached by other state agencies, and Minn. Stat. § 80A.31.

The most important issue raised by the Respondents concerns the constitutionality of applying the securities laws to political organizations under the First Amendment. The Respondents argue that the Minnesota Securities Act. as applied to them, is overly broad and impermissibly imprecise for purposes of the First Amendment because its application

will impair their rights of expression, association and privacy when there is no significant public interest justifying the impairment. Neither the Administrative Law Judge nor the Commissioner has authority to declare an act of the Legislature unconstitutional. Starkweather v. Blair. 71 N.W.2d 869, 884 (Minn. 1955); Quam v. State, 391 N.W.2d 803, 809 (Minn. 1986); Neeland v. Clearwater Memorial Hospital, 257 N.W.2d 366, 368 (Minn. 1977). However, to the extent that a statute must be construed, constitutional principles may be considered by the Administrative Law Judge and the Commissioner in an appropriate case. Jackson Cty. Education Ass'n v. Grass Lake Community, 291 N.W.2d 53 (Mich. App. 1980).

First Amendment freedoms are not absolute. Buckley v. Valec, 424 U.S. 1 (1976); Bates v. City of Little Rock, 361 U.S. 516, 523 (1960). however, government action which curtails First Amendment freedoms must be closely scrutinized, must be supported by a compelling or overriding governmental interest, and must be closely or narrowly drawn. Buckley v. Valeo. supra. When associational and privacy rights come in conflict with state interests, the compelling needs of the government will justify the restrictions if they are, in balance, more important. and are the least restrictive means of accomplishing the government's stated objectives.

The organizational Respondents' position is that the State has no compelling interest to regulate its notes and that the State's regulations will deprive it of its First Amendment rights. They argue, without support in the record, that compliance with the State's securities laws may be prohibitively expensive and might be impossible because the statutes are incompatible with the operations of political organizations. Respondents note, for example, that political organizations do not have set issues of securities or a series of

securities and that they do not issue notes with uniform interest rates or due dates. Moreover, since they continuously raise funds, registration would require them to set specific times to begin and end fundraising and flexibility in the terms of the notes they issue would be virtually impossible to obtain. Respondents also argue that statutory earnings requirements and minimum capitalization restrictions on fund use and vagueness about the required promotional materials that must be filed create insurmountable constitutional problems. In the Respondent's view, the Commissioner cannot monitor the viewpoints of political associations and organizations. The Respondents also point out that political associations' fundraising activities frequently concern current issues which change daily and that it would be virtually impossible to define the offerings or promotional materials in such a circumstance. Moreover, the Respondents argue that the broker/dealer and agent disclosure requirements of the securities laws are completely incompatible with the First Amendment. and that the prospectus requirements alone will make it impossible for a political association to comply with disclosure requirements. They point out that listing its promoters will impair associational rights requiring disclosure of active supporters. Based upon the problems compliance with the securities act may create for political organizations and the extent to which First Amendment rights may be abrogated or impaired, Respondents conclude that the securities act should be limited to commercial or business enterprises and not to political associations, and that if political associations are to be covered. the statute must be rewritten and substantially clarified.

The Respondents' arguments are based on the United States Supreme Court's decision in FEC v. Massachusetts Right to Life,U.S. , 107 S. Ct. 616 (1986). In that case. the Supreme Court decided that Section 316 of the Federal Election Campaign Act is unconstitutional as applied to nonprofit corporations formed to promote political ideas

because it infringed upon protected speech without a compelling justification.

The record does not contain much information about the Respondents. For example, IDL's status as an independent association and as a campaign committee for purposes of-the federal election laws has been.admitted-cut has not been proven. Similarly, while a copy of Caucus' original Articles cf Incorporation is in the record, there is no evidence that the Articles originally.filed have not been amended and no evidence that the limitations in those.-Articles have been followed.- Therefore.the Judge.does not know if monies Caucus obtains are used for political purposes only or whether they have been used for the benefit of particular individuals or business ventures. Moreover, there is no evidence in the record concerning Campaigner and the relationship between Campaigner and Caucus and how funds collected by these organizations are interchanged. commingled or spent. Assuming, however, that it is true that all the organizational Respondents were formed solely to disseminate political ideas rather than to amass capital, and assuming that has been their sole function, the Judge is not persuaded that the Massachusetts Right to Life decision prohibits treating the Respondents' notes as securities. That case simply held that restrictions on the spending of some nonprofit corporations were unconstitutional. It did not state that nonprofit corporations formed to disseminate political ideas can borrow money and issue notes free of any state or federal regulation.

The State's securities law is designed to protect the public from fraud and deception in transactions involving securities, to prevent losses from investments in worthless enterprises, and to protect credulous and incompetent persons from their own inclinations to speculate in hazardous enterprises. State v. Gopher Tire & Rubber Co., 146 Minn. 52. 177 N.W.2d

937 (1920); Bond v. Charlson, 374 N.W.2d 423 (Minn. 1985). These are compelling interests. In Larson v. Valente, 456 U.S. 228, 248. 102 S. Ct. 1673. 1685 (1982), the United States Supreme Court recognized that states have "a significant interest in protecting its citizens from abusive practices in the solicitation xf funds for charity. and that this interest retains importance when the solicitation is conducted by a religious organization." Previously. in Cantwell v. Connecticut, 310 U.S. 296, 306, 60 S. Ct. 900. 904. the court suggested that organizations may not commit frauds upon the public under the cloak of religion. Thus. in World Radio Mission. supra, the court rejected an argument that the securities issued by religious organizations were subject to First Amendment protection. The court held that since sales were solicited from the general public and since the purchases were not contributions made with no real expectation of recovery, but investments made for the secular purpose of obtaining a profit, that they were securities subject to Federal law. The notes said by the organizational Respondents, like the notes sold by world Radio Mission, were offered to the general public as investments. not contributions. While Respondents may have a First Amendment right to spend their money as they wish and to promote whatever political purposes and goals they desire, they do not have a First Amendment right to solicit money in any manner that they desire or to avoid any and all laws governing the sale of securities simply because they have political goals. The Judge is persuaded that the State's interest in preventing fraud authorizes the State to require political and social organizations to register their securities and, if necessary. to file the economic brochures and prospectuses that those groups intend to use to sell them; that is, that regulation is not per se unconstitutional. That does not mean that the Commissioner can review the truthfulness of the political positions of such associations, but he can review the truthfulness and completeness of the economic facts that pertain to the security. Therefore, it is concluded that there is no prohibition from entry of the Cease and Desist order

proposed by the Department. Resolution of any other more specific constitutional problems, in the Judge's view, must be resolved on a case-by-case basis after development of a complete record.

FRAUD

The Department has charged the Respondent, Ron Fredman. with the violation of Minn. Stat. § 80A.Ol, clause (c), by telling Mitchell that some banks were failing and by misdating a promissory note rolled over in April 19B5. Section 80A.Ol states, in part:

> It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly:
>
> (b) to make any untrue statement of material fact or omit to state material facts necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading; or
>
> (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

For purposes of section 80A.Ol, fraud and deceit are not limited to common law deceit. The intent to defraud is irrelevant. Aaron v. SEC, 446 U.S. 680. 697, 100 S. Ct. 1945. 1956 (1980). Therefore, the focus of the law is the

effect of the violation on the public. Van Duyse v. Israel, 486 F. Supp 1382, 1387 (E.D. Wis. 1980). Fredman's statement during the course of his conversations with Mitchell that some or many banks were failing was not shown to have misled Mitchell and was not shown to be untrue. Mitchell at no time believed that her banks were in trouble or that her bank deposits were unsafe, and she knew her bank deposits were insured. Furthermore, it was not even shown that Fredman's statements were made in the course of selling notes to her. rather than in the course of describing the policies. goals and political objectives of the LaRouche organizations. Consequently, it is concluded that the enforcement division has failed to establish that those statements constitute an act, practice or course of business which operated as a fraud upon Mitchell. However, the Judge is persuaded that the Respondents! use of current dates whenever notes were rolled over without making any provision for prior interest payments did constitute an act. practice or course of business that acted as a fraud upon her for purposes of the statute. Although Respondents submitted the affidavit of Ronnie Y. Fredman denying any intent to deprive Mitchell of this interest, the Judge does not find the affiant's statements regarding the rollover note of April 16, 1985 to be persuasive or believable.

The Judge is also persuaded that the Respondents Ronald R. Bettag and Ron Fredman failed 10 state material facts necessary in order to make statements that were made not misleading contrary to the provisions of Minn. Stat. § 80A.Ol(b) by failing to disclose financial information which Mitchell could have used to determine the organizational Respondents' ability to repay the loans she made to them and by telling Mitchell that the loans were legal when the notes were not registered with the Commissioner and Fredman and Bettag were not licensed to sell them. For purposes of the statute. misstated or omitted facts are material if there is a substantial likelihood that a reasonable person would consider

it important in deciding whether to buy a security or if there is a substantial likelihood that the disclosure of the misstated or omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of the information made available. TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976). Although the record does not clearly state how the organizational Respondents hoped to repay Mitchell's loans, if they did, information regarding the source of the funds to be used for repayment and the Respondents' ability to repay those notes would certainly have been important. substantial and material to a reasonable investor's decision to purchase the notes. Bettag and Fredman's statements that the loans were legal and that her investments were safe were certainly misleading without providing her with specific information regarding their financial position and ability to repay. Therefore, the Judge is persuaded that the statute was violated in this case.

J.L.L.

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS

COUNTY DEPARTMENT - LAW DIVISION

DONALD E. FROELICH
Plaintiff
vs
NO: 86 L 17562

CAUCUS DISTRIBUTORS, INC., CAMPAIGNER PUBLICATIONS
INC., SCHILLER INSTITUTE, INC., PAUL GREENBERG,
RONALD BETTAG, and certain unnamed JOHN and JANE DOES, Individually and as agents and employees of affiliates,
Defendants

ORDER

This cause coming to be heard on motion of Defendant, RONALD BETTAG to dismiss Count 1 through and including Count IX of Plaintiff's Complaint pursuant to Code of Civil Procedure X2-615, all parties with due notice, the Court having reviewed the pleadings, and memoranda and argument of counsel, and the Court making findings of law:

(a) Count 1 insufficiently pleads civil conspiracy to commit fraud as to Ronald Bettag;

(b) Count I1 insufficiently pleads breach of contract as to Ronald Bettag;

(c) Counts 111, IV, V, VI, VII and VIII fail to allege facts which establish alleged loans by Plaintiff to any party to be "securities" as contemplated by Illinois Sec. Law of 1953, 111. Rev. Stat. Ch. 121-1/2, X137.1 et.seq. and the Court finds that Plaintiff cannot allege any fact or set of facts to allege a cause of action under said statutes;

(d) Count IX fails to allege facts which establish alleged loans by Plaintiff to any party to be consumer or business or commerce transactions as contemplated by Illinois Consumer Fraud and Deceptive Busines. Practices Act, Ill.Rev.Stat. Ch. 121-1/2, X261 et. seq. and the Court finds that Plaintiff cannot allege any fact or set of facts to allege a cause of action under said statutes;
and the Court being fully advised:

IT IS HEREBY ORDERED:

1. Count 1 of Plaintiff's Complaint is stricken. Plaintiff is given leave to file Amended Count 1 within 28 days.

2. Count 11 of Plaintiff's Complaint is stricken. Plaintiff is given leave to file Amended Count 11 within 28 days.

3. Counts III, IV, V, VI, VII and VIII of Plaintiff's Complaint founded on Illinois Securities Law of 1953,Ill.Rev.Stat.Ch. 121-1/2, X137.1 et. seq., are dismissed.

4. Count IX of Plaintiff's Complaint, founded on Illinois Consumer Fraud and Deceptive Business Practices Act, Ill.Rev.Stat.Ch. 121-1/2, X261 et. seq. is dismissed.

DATE: _____ ENTER:

JUDGE

Attorney X20468
LAW OFFICES OF
STEIN & ROTMAN
105 W. Madison - Suite 605
Chicago, Illinois 60602
236-5375

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT - LAW DIVISION

DONALD FROELICH
Plaintiff, -vs-
No. 86 L 17562
CAUCUS, et al.,
Defendants.

REPORT OF PROCEEDINGS had at the hearing of the above-entitled cause, before the Honorable THOMAS E. HOFF!XAN, Judge of said court, on Thursday, the 7th day of January, A.D., 1987.

PRESENT:
MR. LONNY BEN OGUS,

appeared on behalf of the Plaintiff;

STEIN & ROTMAN, by:
MR. ORIN S. ROTMAN,
appeared on behalf of the Defendant.

Cecilia A. Peterson, CSR,
Official Court Reporter
Circuit Court of Cook County
Law Division

THE CLERK: Froelich versus Caucus. MR. ROTMAN: Good morning, your Honor. Orin Rotman, representing the defendant, Patag.

MR. OGUS: Lonny Ben Ogus, representing the plaintiff, Donald Froelich.

MR. ROTMAN: I will make my comments very short since 7 the Court has had all the pleadings. This is defendant's motion to strike Counts I through and including IX for failure to state a cause of action or in the alternative a mc,re definite statement.

There are two factual allegations made with regard to Ronald Patag. One is that he was agent of some undetermined corporation, one of and/or three corporations. The other allegation is in an affidavit which is in Exhibit C to the complaint wherein Mr. Patag is alleged to have had a conversation with the plaintiff in January or February of 1986 regarding post-due promissory notes.

Count I of the complaint does not incorporate the affidavit, Exhibit C, so the only allegation as to Mr. Patag is that he was the agent of one of the three corporations or maybe all of them. That does not engage him as a conspirator for fraud.

Count two is for breach of contract. There is no contract alleged against Mr. Patag. There are promissory notes executed by different entities. There is no contract of personal

undertaking in the conversation set forth in paragraph 13 of Exhibit C.

Count III through VIII are based on statutory actions by the allegation based on conduct between September 1984 and December 1984. The only allegation by Mr. Patag is conversation of January and February 1986, no action which could come within the purview of the statute of the allegations in Counts III to VIII.

Count IX under fraud and deceptive business practices, clearly that is not under the items previously stated because also these are political loans for election campaign set forth by plaintiff in his affidavit and have no relationship to business transactions whatsoever.

MR. OGUS: Very simply, your Honor, this was a pattern of acts of the LaRouche group to get my client to give them money with the intention of never repaying it. He gave him $78,000, goes through serious machinations to take his money without his consent on some occasions, with his consent on some occasions, but with certain promises that they would repay it. They didn't tell him what they were doing with it and things like that.

Defendant, Patag, the only defendant before this Court at this time, is alleged to be an agent representative of the three groups, Caucus, Campagner and Schiller. And the complaint affidavit talks about being asked by Mr. Patag to do certain things concerning the loans that he had already given to those corporations and what he would do if he did certain things and things like that.

Very clearly this is a fraud. We allege fraud and particularly in a fraud situation one co-conspirator is liable for all the acts of the other co-conspirator as long as they know

what is going on.

THE COURT: You never pled a cause of action in civil conspiracy. That is separate and apart from fraud. It is a separate count. You have him on Count I -- separate fraud, that he committed the fraud. It becomes apparent from the allegations in Count I. You haven't pled all of the elements of the cause of action for fraud against this defendant. I know where you're going. You want to allege civil conspiracy and want to make him responsible for that, which Greenberg did, and all the rest of them did That's fine, but you have to plead civil conspiracy. Unless you plead civil conspiracy that they acted in concert, intending to achieve a given result, 21 although each one of them may have done a separate part of the fraudulent scheme, you haven't got a cause of action against them. Just because he is an agent and representative of corporations that may have defrauded your client arguably, unless you can allege he is the one that committed the fraud he is not, as an agent, liable for the fraud of his principal.

MR. OGUS: What we're saying, he was part and parcel of the whole scheme.

THE COURT: Fine. Where did you say that? Where is that? Where is the cause of action for conspiracy?

MR. OGUS: On number 21.

THE COURT: The bare allegation that defendants were part of the scheme to induce plaintiff to lend money and obtain access to plaintiffs CMA?

MR. OGUS: That is what they did.

THE COURT: There is nothing wrong with inducing someone to lend money to another unless the lending of the money is done under fraudulent circumstances. It has !7 to be a conspiracy to commit fraud. It has to be a conspiracy to do it by illegal means.

MR. OGUS: 17 and 18 I believe we pled both of those.

THE COURT: Which defendant?

MR. OGUS: All of them were acting together. One does it, one makes a call one time, another one makes a call another time.

THE COURT: Unless you set up the elements of the cause of action for civil conspiracy Count I does not state a cause of action. By using the phrase defendants, without describing who you're talking about doesn't say the issue which you have sufficiently laid out that it was Greenberg who solicited the loans and didn't tell plaintiff the funds were being received by a corporate defendant. Schiller is the one who withdrew money from a cash management account. You don't allege that Patag did any.of these things. If you want to allege he was involved in a civil conspiracy allege it and plead it. Count I is stricken.

As to Count II, for breach of contract, he is not a party to this contract and if it's intended to be some oral contract between him and the plaintiff then that particular case I would refer you to Martin Trigona versus Bloomington, 101 Ill. App. 3d. 943. That will tell you what must be pled in order to state a cause of action for breach of contract. And mere base allegations that there was an offer, there was an acceptance and there was consideration without more is insufficient to state a cause of action for breach of oral contract.

There must be factual allegations to support those X3 conclusions of law and there aren't any here, not as against this defendant. Certainly he's not a party to this unsecured promissory note. His name doesn't appear anywhere on it. By the terms of these contracts, and I presume these contracts are promissory notes that you exhibit, and the oral contract set out by his affidavit, I don't see any breach of contract here. I am going to strike that one. If you want to replead it, go ahead.

As to the Counts III through VIII, based on Illinois Security Law, Illinois Security Law deals with securityregulations including registration of dealers and sellers engaged in selling securities, contains certain anti-fraudand penalties. A security must be involved in the alleged cause of action. 2.1 specifically says:

> "Security means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, investment fund share, face amount certificate, voting trust certificate, fractional undivided interest in oil, gas, or other mineral lease, right or royalty, option, put, call, "privilege, indemnity or any other right to purchase or sell a contract for the future delivery of any commodity offered or sold to the public and not on a registered contract market, or, in general, any interest or instrument commonly known as a security, or any certificate of deposit for, certificate of

interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase any of the foregoing."

CHAPTER 121-1/2, 137.2-1.

"A security within the Illinois Security Law and Federal Securities Act is a contract, transaction or scheme whereby one person invests his money in a common enterprise on the theory that he expects to receive profits solely from the efforts of the other.

Hoffer versus Lorrie, 552 Ill. App. 29, was denied at 86 Supreme Court 237:

"In determining whether an instrument is a security within Illinois Securities Law or the Federal Securities Act the Court looked at the substance of the transaction, the relationship between the parties, elements of control as against the form of the instrument."

Here the substance of plaintiff's nine count complaint was a loan made to a political campaign of Mr. Lyndon A. Larouche, allegedly loans were to be made "-- and funds collected from the federal government as !3 national collection funds, totaled about $9,000, to be 1X paid in three years with 14 percent interest.

Despite your allegation the loan name Larouche campaign is not a securities law. An enterprise is not involved in a business sense. Plaintiff did not make an investment with an

expected return as the terms are commonly used. All he did was loan some money and expect some interest on it. If this falls within the securities law then every promissory note issued by any person that contains an interest rate falls within the securities law and it simply does not. These are not securities as within the means of our securities law.

The Illinois Consumer Fraud and Deceptive Business Practices Act will authorize you to pursue a cause of action for deceptive commercial conduct. You have to have a deceptive act of practice relied on and a deception must occur. But in reviewing the private rights of action the Courts are guided by the terms of Section 11 (a) of the statutes which expressly provides that the action be literally construed to effect its purpose.

Here the deceptive practice complained of is omissions of material facts involving repayment of money with interest, matching election funds, payment of funds in the event of illness or catastrophe, etcetera. In all, plaintiff claims defendant falls within the act and they solicited loans or investments or contributions from Illinois residents which constitute unfair or deceptive acts of practice within the meaning of the act. But you must be a consumer or borrower or businessman in order to have standing to bring an action under our Consumer Fraud and Deceptive Business Practices Act.

Consumers are persons who purchase, make purchases or contract for purchase of merchandise not for resale in the ordinary course of business, but for use in their household. Their term trade or commerce is advertising for sale or sale for distribution of services, property tangible or intangible, real, personal or business, any other article, commodities or anything of value, wherever situated, directly or indirectly

affecting people of this state.

Plaintiff hasn't alleged any facts to illustrate that this cause for deceptive activity falls within the parameters of our act. Plaintiff has not shown he is a consumer of any kind. He has not shown that the defendant is engaged in the trade or commerce or profession unless one would suggest that conducting political activity is a trade or commerce. Nothing has occurred within a trade or commerce.

I don't see any violation of the Illinois Consumer Fraud and Deceptive Business Practices Act which has been pled here. In sum total I am going to strike Counts I and II. Counts III through IX, I am not only striking I am dismissing with a finding there was no posit of facts in spite of plaintiffs complaint that would entitle them to relief under either our securities law or in the alternative under Consumer Fraud and Deceptive Trade Practices. That will be the order. (Which were all the proceedings and in the above-mentioned cause.)

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT - LAW DIVISION

Ithe Honorable THOMAS E. HOFFMAN, Judge of the Circuit Court of Cook County, presiding judge at the hearing of the aforementioned cause, do hereby certify that the above and foregoing is a true and correct Report of Proceedings had at the said hearing.

AND, FORASMUCH, THEREFORE, as the matters and things hereinbefore set forth do not otherwise fully appear of record, the attorney for the tenders this Report of Proceedings and prays that the same may be signed and sealed by the judge of this court pursuant to the statute in such case made and provided.

WHICH IS ACCORDINGLY DONE

this ____ day of _____, 1988.

HONORABLE THOMAS E. HOFFMAN

Circuit Court of Cook County, Illinois

IN THE CIRCUIT COURT OF COOK COUNTY,
ILLINOIS COUNTY DEPARTMENT - LAW DIVISION

I, CECILIA A. PETERSON, an Official Court Reporter for the Circuit Court of Cook County, County Department/Law Division, do hereby certify that I reported in shorthand the proceedings had at the hearing in the above-entitled cause; that I thereafter caused the foregoing to be transcribed into typewriting, which I hereby certify to be a true and accurate transcript of the proceedings had before the Honorable THOMAS E. HOFFMAN, Judge of said court.

Official Court-Reporter

Dated this 12th day
of January, 1988.

STATE OF MICHIGAN
COURT OF APEALS

HARRY W. AGNSORGE, CLAUDE BOONE, CARL BOONE, GORDAN BUGAI, JULIUS BUGAI, DONALD CARLSON, RUDOLPH CARLSON, OSCAR CHRISTIANSON, STANLEY CHRISTIANSON, JAMES ECKERLE, GEORGE FREDERICKSON, FREDERICKSON FARMS, JAMES HOPKINS, HOWARD HUNT, MARTIN JELINEK, JOHN KILCHERMAN, GERTRUDE KIMMERLY, JEROME KOLARIK , JULIUS KOLARIK SR., JULIUS KOLARIK JR., LARS LEE, WHITNEY LYON, MORK & SONS, A Michigan co-partnership, KENDALL PROBST, SHERWOOD PROBST, LEWIS RANGER, JOSEPH SHIMEK, EMILY NASH SMITH, NORA SWENSON, CHARLES VAN PELT, RONALD J. VONHOLT, conducting business as VONHOLT FARMS, GARY WATSON AND LINTON WATSON,

Plaintiffs-Appellants/Cross-Appellees,

-v-

DAVID R. KELLOGG, DOROTHY JANE KELLOGG, RAY ELLSWORTH KELLOGG and GERALD THOMAS STEIN, jointly and severally,

Defendants-Appellees/Cross-Appellants.

BEFORE: Cynar, P.J., E.A. Weaver and J.H. Hausner* , JJ.

PER CURIAM

Plaintiffs appeal by right from a Grand Traverse Circuit Court judgment of no cause of action in favor of defendants.

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* Circuit judge, sitting on the Court of Appeals by assignment.

Defendants claim a cross-appeal from the same judgment. We affirm

The Traverse City Canning Company (TCCC), a Michigan corporation, operated a fruit processing and canning business for approximately fifty years. The company went bankrupt in 1982. Defendants are the officers, directors and shareholders of the bankrupt corporation. Plaintiffs are commercial cherry growers who had business dealings with the TCCC over the years.

According to the testimony adduced at trial, a typical plaintiff, upon the harvest of his cherries, would deliver the fruit to the TCCC for processing, The plaintiff did not receive immediate payment for his crops. Instead, the grower received a weigh ticket a a receipt. About thirty days after harvest, the typical plaintiff would receive a statement from the TCCC showing the amount owing to the grower after taxes. The amount owning constituted the balance of th grower's account. Commonly, partial payment was made by the TCCC at that time. Subsequent payments by the TCCC were generally made upon the request of the grower. Growers commonly left their money in their growers' accounts, which were interest bearing accounts. It was established at trial that these dealings were typical of industry-wide practices.

In 1979, the TCCC suffered significant financial losses due to high interest rates and poor harvest yields. As a result, the TCCC concluded that it would be unable to make full payments on the growers' accounts if same was demanded by the growers. Consequently, in November, 1981, the TCCC mailed to each grower that grower's account statement and a promissory note.

Plaintiffs had not requested the October, 1981 promissory notes; plaintiffs did not negotiate with the TCCC with regard to the terms of he notes. The issuance of the promissory notes was a unilateral act on the part of the TCCC.

Thereafter, on February 2, 1982, the TCCC petitioned for Chapter XI reorganization under federal bankruptcy laws. As a result of the bankruptcy proceedings, plaintiffs did not receive the amounts owed to them by the TCCC. Plaintiffs, therefore, filed the instant action seeking to impose personal liability on defendants under the Michigan Uniform Security Act (MUSA), MCL 451.801 (1), and that, therefore, the MUSA was inapplicable. Moreover, specifically as to the notes issued to Emily Nash Smith and Julius Bugai, the trial court found that those plaintiffs had made bona fide loans to the TCCC; thus, those transactions came within the exception to the MUSA found in §401(j) (6) (A). On appeal, plaintiffs challenge these findings as clearly erroneous.

We are first asked to determine whether the promissory notes issued by the TCCC and the growers' accounts maintained by the TCCC were "securities" within the meaning of the statutory provision. In making this determination, we do not write on a clean slate. Well-settled principles enunciated by the appellate courts of this state establish that the notes and evidence of indebtedness received by plaintiffs were not procured for purposes of speculation and investment and, therefore, do not fall within the ordinary concept of a security.

Section 301 of the MUSA, MCL 451.701; MSA 19.776 (301), makes it unlawful for any person to offer or sell any security in the state unless it is registered under the act of the security or the security or transaction was exempted under §402. The purpose of this statutory restriction on th offer or

sale of securities is to protect the public against fraud and deception in the issuance, sale, exchange or disposition of securities. People v Dempster, 396 Mich 700, 704; 242 NW2d 381 (1976). As a matter of judicial policy, the act should be broadly construed to effectuate this purpose. Id.

The word "securities" is defined in §401 (1) as follows:

"'Security' means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting-trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease; or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. 'Security' includes any contractual or quasi contractual arrangement pursuant to which: (1) a person furnishes capital, other than services, to an issuer; (2) a portion of that capital is subjected to the risks of the issuer's enterprise; (3) the furnishing of that capital is induced by the representations of an issuer, promoter, or their affiliates which give rise to a reasonable understanding that a valuable tangible benefit will accrue to the person furnishing the capital as a result of the operation of eh enterprise; (4) the person furnishing the capital does not intend to be actively involved in the management of the enterprise in a meaningful way; and (5) a promoter or its affiliates anticipate, at the time the capital is furnished, that financial gain may be realized as a result thereof..."

We reject at the outset any suggestion that the present transaction, memorialized by the issue of "notes" and "evidence of indebtedness," must be considered a security transaction simply because the statutory definition of security includes the words "any note...[or] evidence of indebtedness." Rather, we adhere to the basic principles that have guided the appellate courts in this state in their decisions in this area.

In general, the courts that have interpreted Michigan's security statutes have been careful to look beyond the form of the transaction to its substance, paying special attention to the economic realities of the situation. People v Breckenridge, 81 Mich App 6, 16-17; 264 NW2d 99 (1978), lv den 402 Mich 915 (1978); Dep't of Commerce v DeBeers Diamond Investment Ltd, 89 Mich App 406, 409-410; 280 NW2d 547 (1979), lv den 406 Mich 998 (1979). Whether a particular transaction must be considered a security transaction depends upon the statutory language, the real nature of the transaction, and the real intent and purpose of the parties, looking beyond labels and devices. People v Blankenship, 305 Mich 79, 85-86; 8NW2d 919 (1943); Breckenridge, supra; Prince v Heritage Oil Co., 109 Mich 198, 197; 311 NW2d 741 (1981); Moffit v Sederlund, 145 Much App 1, 15; 378 NW2d 491 (1985) lv den 425 Mich 860 (1986).

In Breckenridge, supra, this Court considered the applicability of the MUSA to a transaction involving promissory notes. The Court noted that the salient feature of a securities sale under the MUSA is the public solicitation of venture capital to be used in a business enterprise. The Court, quoting with approval from Bronstein v Bronstein, 407 F Supp 925, 930 (ED Pa, 1976), then opined:

"'The question whether a note constitutes a covered security depends on whether the note was procured for purposes of speculation or investment or for purposes of making a commercial loan. As a matter of policy, this distinction is a valid one. The federal securities laws are designed to protect investors, not persons engaged in ordinary consumer or commercial loan transactions * * *. Thus courts have restricted application of the Acts to those notes procured for investment and have excluded notes issued in the context of a commercial loan transaction." Breckenridge, supra, 15-16.

With these general principles in mind, we return to the language of §401 (1). We read the expressly enumerated factors set forth in §401 (1) to constitute the factors to be considered i determining the investment character of a transaction. In the context of a "note" or "evidence of indebtedness" these factors would aid th court in distinguishing an investment or securities transaction from a loan transaction. From our review of the record, we find that the trial court properly used these factors to determine the investment character of the transaction.

We also conclude that the trial court's finding that the notes and accounts did not constitute securities within the meaning of $401 (1) was not clearly erroneous. Trial testimony established that plaintiffs' accounts arose as a result of industry-wide practices regarding the dealings between growers and independent fruit processors. Each grower had the option to request payment of all or any part of his or her account balance from the TCCC. Any portion of the balance which remained with the TCCC bore interest at fixed rate and, therefore, the return to plaintiffs was not dependent on the profit made by the TCCC. The promissory notes issued to plaintiffs in October, 1981, were merely a consolidation of the

plaintiffs' account balances through 1980. The return promised on these notes was premised on a rate of interest and not on the profits of the TCCC. Finally, the testimony of individual plaintiffs demonstrated that they understood the nature of the transaction with the TCCC as a loan rather than as an investment.

We are next asked to determine whether the trial court clearly erred when it found that plaintiffs Julius Bugai and Emily Nash Smith had made "bona fide loans" to the TCCC and, therefore, that the transactions were not security transactions governed by the MUSA.

The terms "offer" and "sale" are defined in §401 (j). Section 401 (j) (6) (A) specifically excludes "any bona fide loan" from the definition of these terms.

The record establishes here that the promissory notes issued to Smith and Bugai were given in change for cash. Bugai testified at trial that he intended to make a loan to the TCCC. These fact coupled with the fact that the notes were interest bearing at a fixed rate, and return did not depend on the profits of the TCCC, indicates that the transactions were loans rather than investments. Accordingly, we conclude that the trial court did not clearly err in finding as fact that Smith and Bugai had made bona fide loans to the TCCC.

On cross-appeal; we are asked to determine whether the trial court erred in denying an award of attorney fees to defendant pursuant to MCR 2.403

A party is liable for the opposing party's attorney fees under MCR 2.403 (o) only if the party has rejected the evaluation and the verdict is less favorable to the rejecting party (by more than ten percent) than the mediation evaluation.

In the instant case, plaintiffs rejected the May 15, 1985 mediation evaluation. Defendants accepted same. We, however, find that the mediators issued no valuation which could be accepted or rejected by the parties. While the mediators did find that defendants were liable to plaintiffs, they left the issue of damages open and invited the parties to submit additional material on the issue. Both parties to submit additional material on the issue. Both parities accepted this invitation. The mediators failed to place a value on plaintiffs' damages prior to the trial. Accordingly, the May 15, 1985 mediation evaluation presented no settled decision. Thus because plaintiffs might have accepted the mediation valuation if they had not expected further action as to the issue of damages, we conclude that it would be unfair to subject plaintiffs to eh penalty provisions of MCR 2.403 (o).

Defendants also ask us to determine whether the trial court clearly erred when it found that defendants Dorothy Jane Kellogg, Ray Ellsworth Kellogg and Gerald Thomas Stein had failed to meet the burden imposed upon them by MCL 451.810(b); MSA 19.776(b). Because we have determined that the trial court correctly found that the instant transaction was not governed by the MUSA, we declined to make such a determination.

Defendants' remaining issues were not addressed by the trial court. We, therefore, decline their review. People v Turner, 123 Mich App 600, 604; 332 NW2d 626 (1983).

Affirmed

/s/ Walter P. Cynar
/s/ Elizabeth A. Weaver
/s/ John H. Hausner

August 26, 1986
Dear DFLer,

I enthusiastically support Ray Stock in his bid to upset Bill Frenzel.

Ray has a big task ahead of him, and he needs you help. First, he must defeat a LaRouche disciple-Stanley Bentz-in the primary, and then take on the entrenched Bill Frenzel.

Ray needs you to vote in the Primary on Sept 9. We must show the nation that Minnesota will not tolerate the La Rouche fringe. Ray intends to see that what happened in Illinois does not happen here.

Ray needs you to knock on doors, make telephone calls, lick stamps, drop literature, and write letters to the editor. He already has an active group of more than 150 volunteers, but more are needed. Ray will work hard.

Ray also needs your dollars. He can't match Frenzel's war chest stuffed with PAC dollars; but your contribution of $35, $50 or $100 will make a difference. Ray will use your money wisely.

Ray Stock is a man of deep conviction and compassion. He was moved to challenge Bill Frenzel because of Frenzel's callous contra aid vote. For Ray it was just one more example of Frenzel's disregard for what is right and his blatant disregard fo the views of the people of the Third District.

> Once again, Bill–the media "moderate"–has voted on both sides of the issue; and when the vote counted, Frenzel was on the wrong side– the Reagan side.

Ray believes the security of his two little girls and of all our children depends not on MX missiles, Star Wars defense systems and a $300 billion defense budget, but on hard-headed negotiations, finding new and creative ways to solve conflict, and on finding our common humanity. He believes education is the key to our future. He believes that clean air and clean water are our birthright and that the federal government has the responsibility to see that our environment is safe and clean. And he believes that our deficit-ridden-buy now, pay later-economy is a poor legacy to leave our children.

Ray believes, and I believe, that Bill Frenzel has not and will not provide the leadership we need to solve these problems. Ray Stock will.

Ray knows that beating Bill Frenzel will be difficult. But in a short time he has put together an impressive, well, organized campaign. Ray's energy, enthusiasm, and conviction are contagious. When people tell Ray that Bill Frenzel can't beat, he tells them: "Don't bet on it."

Tim Penny proved the experts wrong in 1982. Ray Stock plans to do the same in 1986.

But to upset Bill Frenzel. Ray needs your help. He needs you to:

VOTE SEPTEMBER 9: Stanley Bentz must be soundly defeated;

VOLUNTEER: call 927-9298 to see how you can help;

CONTRIBUTE: you get tax credits for your contributions.

Ray needs and deserves our support. With your help we can put Ray Stock in Congress.

Best regard,

/s/ Hubert Humphrey, iii

Attorney General

P.S. On September 3, please join me at an open house for Ray. It will be at the Stock for Congress campaign headquarters at 4005 West 65th Street, Suite 223, in Edina. The time is from 5:00 p.m. to 8:00 p.m. I hope you can come. It will be a great chance to get to know Ray.